

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
AND
INDEPENDENT AUDITORS' REPORT

YEAR ENDED SEPTEMBER 30, 2004

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2004

TABLE OF CONTENTS

	<u>Page No.</u>
I. Independent Auditors' Report	1
II. Basic Financial Statements	
Management's Discussion and Analysis	3
Government-Wide Financial Statements:	
Statement of Net Assets	10
Statement of Activities	11
Governmental Fund Financial Statements:	
Balance Sheet	12
Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)	13
Reconciliation of Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	14
Proprietary Fund Financial Statements:	
Statement of Net Assets	15
Statement of Revenues, Expenses, and Changes in Net Assets	16
Statement of Cash Flows	17
Discretely Presented Component Unit Financial Statements:	
Combining Statement of Net Assets	18
Combining Statement of Revenues, Expenses, and Changes in Net Assets	19
Notes to the Basic Financial Statements	20
III. Required Supplementary Information - Other than Management's Discussion and Analysis	42
Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual - General Fund	43
Note to Required Supplementary Information - Budgetary Reporting	44
IV. Other Supplementary Information	45
Combining Schedule of Expenditures by Account - Governmental Funds	46
General Fund:	47
Statement of Revenues, Expenditures by Function, and Changes in Fund Balance	48
Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual	50

STATE OF YAP
FEDERATED STATES OF MICRONESIA

FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2004

TABLE OF CONTENTS, CONTINUED

	<u>Page No.</u>
IV. Other Supplementary Information, Continued	
Nonmajor Governmental Funds:	
Combined Balance Sheet	52
Combined Statement of Revenues, Expenditures by Function, and Changes in Fund Balances	53
Combined Statement of Revenues, Expenditures by Account, and Changes in Fund Balances	54
Nonmajor Governmental Funds - Special Revenue Funds:	55
Combining Balance Sheet	56
Combining Statement of Revenues, Expenditures by Function, and Changes in Fund Balances (Deficit)	57
Combining Statement of Revenues, Expenditures by Account, and Changes in Fund Balances (Deficit)	58
Nonmajor Governmental Funds - Capital Project Funds:	59
Combining Balance Sheet	60
Combining Statement of Expenditures by Function, and Changes in Fund Balances (Deficit)	61
Combining Statement of Expenditures by Account, and Changes in Fund Balances (Deficit)	62
Compact of Free Association Section 211(a) Sector Grant Funds:	
Combining Balance Sheet	63
Combining Statement of Expenditures by Function, and Changes in Fund Balances (Deficit)	64
Combining Statement of Expenditures by Account, and Changes in Fund Balances (Deficit)	65
V. Independent Auditor's Report on Internal Control and on Compliance	
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit Performed in Accordance with Government Auditing Standards	66
Independent Auditor's Report on Compliance and Internal Control Over Compliance Applicable to Each Major Federal Award Program and on the Schedule of Expenditures of Federal Awards	68
Schedule of Expenditures of Federal Awards	70
Notes to Schedule of Expenditures of Federal Awards	78
Schedule of Program Selected for Audit in Accordance with OMB Circular A-133	79
Schedule of Findings and Questioned Costs	80
Unresolved Prior Year Findings and Questioned Costs	96

INDEPENDENT AUDITORS' REPORT

Honorable Robert Ruecho
Governor, State of Yap
Federated States of Micronesia:

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap (the State), as of and for the year ended September 30, 2004, which collectively comprise the State's basic financial statements as set forth in Section II of the foregoing table of contents. These financial statements are the responsibility of the management of the State. Our responsibility is to express an opinion on the respective financial statements based on our audit. We did not audit the financial statements of the Public Transportation System, which represents the State's business-type activities or the Yap Visitor's Bureau, the Yap Fishing Authority, and the Diving Seagull, Inc., which represent 36% and 61%, respectively, of the assets and revenues of the State's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Public Transportation System, the Yap Visitor's Bureau, the Yap Fishing Authority, and the Diving Seagull, Inc. are based solely on the reports of the other auditors.

Except as discussed in the following paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. The financial statements of the Diving Seagull, Inc., were audited in accordance with auditing standards generally accepted in the United States of America, but were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

As more fully described in note 2 to the financial statements, the State's General Fund has invested \$500,000 in an airline that has ceased operations. In our opinion, such investment should be stated at the lower of cost or market value to conform with accounting principles generally accepted in the United States of America. Due to the lack of readily available information concerning the carrying value of this investment, the effect of this departure on the financial statements is not reasonably determinable.

Because of inadequacies in the accounting records and the internal control over financial reporting, schedules to support the carrying value of capital assets for the Yap Fishing Authority and the Diving Seagull, Inc. were not available, nor were the audited financial statements of Yap Fresh Tuna, Inc., a 50%-owned subsidiary in which the Yap Fishing Authority is deemed to have a controlling interest, available to be consolidated with the financial statements of the Yap Fishing Authority. Consolidation of Yap Fresh Tuna, Inc. financial statements with the financial statements of Yap Fishing Authority is required to conform to accounting principles generally accepted in the United States of America.

In our opinion, except for the effects of the matter discussed in the third paragraph above, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the General Fund for the State of Yap as of September 30, 2004, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

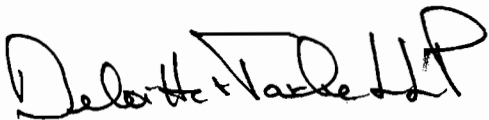
In addition, in our opinion, based on our audit and the reports of other auditors, because of the effects of the matter discussed in the fourth paragraph above, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the aggregate discretely presented component units of the State of Yap as of September 30, 2004, and the changes in financial position thereof for the year then ended.

Finally, in our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, the U.S. Federal Grants Fund, the Compact Sector Grants Fund, the Compact Capital Projects Fund, the Compact Trust Fund, and the aggregate remaining fund information of the State of Yap as of September 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, on pages 3 through 9, as well as the Schedule of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund and notes thereto, on pages 43 and 44, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the management of the State. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the State's respective financial statements that collectively comprise the State's basic financial statements. The combining and individual fund financial statements, as set forth in Section IV of the foregoing table of contents, which are also the responsibility of the management of the State, are presented for purposes of additional analysis and are not a required part of the basic financial statements of the State. Such additional information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 6, 2006, on our consideration of the State's (Primary Government only) internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



March 6, 2006

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2004

This analysis, prepared by the Department of Administrative Services, offers readers of the Yap State Government's (Yap State) financial statements a narrative overview of the activities of the government for the fiscal year ended September 30, 2004. We encourage readers to consider this information in conjunction with Yap State's financial statements, which follow. Fiscal year 2003 comparative information has been included, where appropriate. This analysis is required by the Governmental Accounting Standards Board, (GASB) which provides guidelines on what must be included and excluded from this analysis.

FINANCIAL HIGHLIGHTS

- For the fiscal year ended September 30, 2004, Yap State's total net assets increased by \$0.49 million from \$92.07 million in the prior year to \$92.56 million. This increase is primarily attributable to increases in the fair value of investments.
- During fiscal year 2004, Yap State's revenues of \$19.45 million exceeded total expenditures (\$18.59 million) by \$492,000. Both revenues and expenditures were down from fiscal year 2003, by \$18.5 million (or 48%) and \$9.35 million (or 33%), respectively. This decrease was primarily due to the decline in Compact funding (\$8.35 million). Compact revenues decreased from \$15.07 in fiscal year 2003 to \$6.72 million in fiscal year 2004 (down 55.4%).
- Budgetary stability was maintained in fiscal year 2004: revenues available for appropriation were \$1.31 million more than budgeted for the general fund, primarily as the result of the net increase in the fair value of investments (\$3.1 million). Likewise, the expenditure budget also reflected positive budget variances. General fund expenditures of \$6.06 million were \$0.43 million (or 10%) under general fund appropriations of \$6.49 million.
- The unreserved surplus of the General Fund increased by \$0.57 million (up 2.9%); increasing from \$19.62 million in the prior year to \$20.19 million in FY-04. The combined value of Yap State's investments and its equity interest in the investment pool maintained by the FSM National Government increased by \$2.61 million (up 4.8%), rising to \$56.66 million in FY-04 from the prior year's \$54.05 million.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Yap State's basic financial statements. Yap State's basic financial statements comprise three components: 1) governmental-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the budgetary basis of accounting, and other optional supplementary information, in addition to the basic financial statements themselves, which includes combining statements for governmental funds and component units.

Government-Wide Financial Statements

The government-wide statements report information about Yap State as a whole using accounting methods similar to those used by private-sector companies. It provides both long-term and short-term information about the State's financial status.

The statement of net assets includes all the government's assets and liabilities. The difference in the two is called net assets. Over time, increases or decreases in the State's net assets serve as an indicator to measure the State's financial position.

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2004

The statement of activities on the other hand, account for the State's current year's revenues and expenses regardless of when cash is received or paid.

The government-wide financial statements of Yap State are divided into three categories:

- Governmental activities -- Most of Yap State's basic services are included here, such as education, health, special appropriations, finance, judiciary, and general administration. Federal grants finance most of these activities.
- Business-type activities -- Yap State reports the operations of its Public Transportation System, which charges tariffs to help cover the costs of the transportation services it provides.
- Component Units -- Yap State includes the operating results of the Yap Visitor's Bureau, the Yap State Public Service Corporation, the Yap Fishing Authority, and The Diving Seagull, Inc. in its report. Although legally separate, these "component units" are important because Yap State is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about Yap State's significant funds. Funds are accounting devices that Yap State uses to keep track of specific sources of funding and spending for particular services. The State uses fund accounting to comply with financial and related legal requirements.

Yap State has two types of funds:

- Governmental funds. Most of Yap State's basic services are included in governmental funds, which focus on (1) how cash and other financial assets that can be readily be converted to cash flow in and out, and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps determine whether there are more or fewer financial resources that can be spent in the near future to finance Yap State programs. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explains and reconciles the relationship (or differences) between them.
- Proprietary funds. Services for which Yap State charge customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both long- and short-term financial information.

FINANCIAL ANALYSIS OF YAP STATE AS A WHOLE

Net assets may serve over time as a useful indicator of a government's financial position. At the end of fiscal year 2004, Yap State's assets exceeded liabilities by \$92.56 million. Of its total net assets, \$28.95 million (31.3%) are restricted as to the purposes they can be used for. Another \$36.85 million (39.8%) can be used for or are invested in capital assets (buildings, roads, etc.). Yap State uses these capital assets to provide services to its citizens; consequently, these assets are not available for future spending. Although Yap State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The following schedule summarizes Yap State's net assets as of September 30, 2004:

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2004

	<u>2004</u>	<u>2003</u>
Current and other non-capital assets	\$ 63,894,514	\$ 61,483,151
Capital assets	36,845,291	37,298,153
Total Assets	\$100,739,805	\$ 98,781,304
Other liabilities	\$ 4,004,908	\$ 2,991,085
Long-term liabilities	4,175,966	4,163,942
Total Liabilities	8,180,874	7,155,027
Net Assets		
Invested in capital assets, net of related debt	36,845,291	37,739,079
Restricted	28,952,930	29,771,953
Unrestricted	26,760,710	24,556,171
Total Net Assets	\$ 92,667,020	\$ 92,067,203

At the end of fiscal year 2004, Yap State's unrestricted assets show a surplus of \$26.76 million (28.9% of total net assets). These funds are included in Yap State's investment portfolio and are available for discretionary purposes subject to appropriation by the Yap State Legislature. Yap State's assets increased by \$1.96 million, but there were marked differences between the composition of revenues and expenditures from fiscal year 2003. Key elements are the increase and the differences from the prior year are shown in the following schedule:

	<u>2004</u>	<u>2003</u>
Revenues:		
Program Revenues:		
Charges for services	\$ 913,562	\$ 1,370,191
Operating grants and contributions	10,984,691	6,170,668
Capital grants and contributions	83,117	13,701,617
General Revenues:		
Taxes	3,779,210	2,608,394
Grants and contributions not restricted	-	7,523,302
Unrestricted investment earnings	3,118,031	5,878,201
Other	572,598	728,249
Total revenues	19,451,209	37,980,622

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2004

Expenses:		
General government	3,951,061	4,095,273
Health Services	2,569,765	2,469,394
Education	4,230,554	4,155,707
Economic development	802,035	1,215,413
Public Safety	709,102	621,547
Public works and transportation	4,088,738	5,545,479
Community affairs	574,651	955,222
Boards and commissions	580,117	292,384
Payments to components	572,664	683,470
Judiciary	210,270	227,284
Public auditor	87,748	57,606
Capital projects	46,553	577,974
Other	536,223	7,416,399
Total expenses	18,959,481	28,313,152
Change in net assets	491,728	9,667,470
Net assets at the beginning of the year	92,067,203	82,399,733
Net assets at the end of the year	\$ 92,558,931	\$ 92,067,203

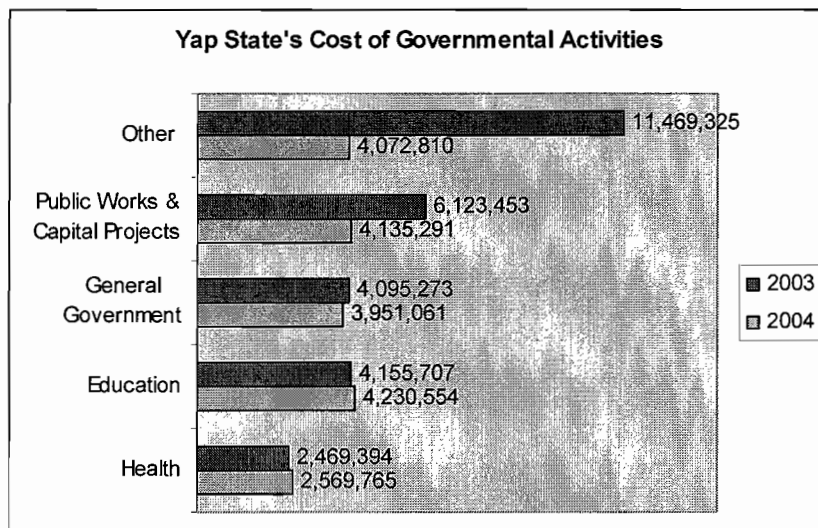
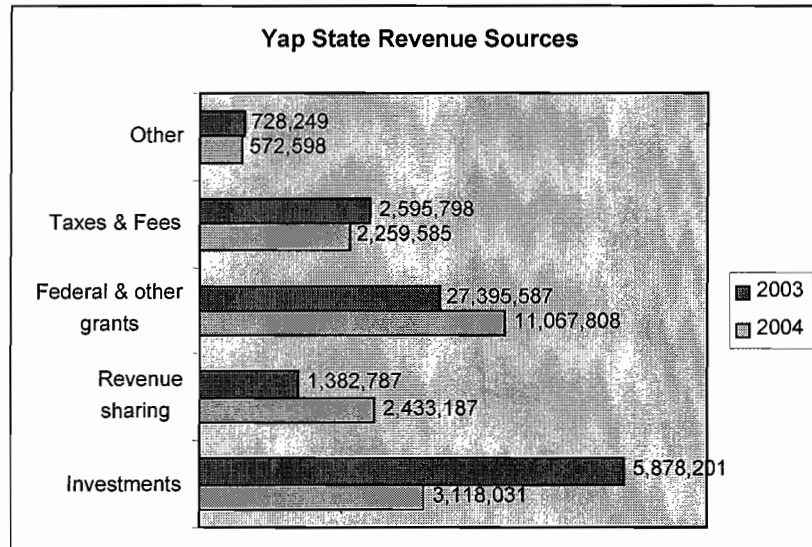
Total revenues in FY-04 of \$19.45 million significantly decreased from the prior year's \$37.98 million (down 48.8%) primarily due to the notable declines of capital grants and discretionary operating grants as the result of the amended fiscal provisions of the *Compact of Free Association* and the delay in implementation of the Compact Public Infrastructure grants.

Total expenditures in FY-04 of \$18.96 million also proportionately declined from fiscal year 2003's \$28.31 million (down 33%). The 'other' category of expenditures in FY-03 reflects \$7.4 million of bad debt write-downs that represented management's decision to remove from Yap State's balance sheet certain long-outstanding investments and inactive accounts receivable, which consequently, did not occur in fiscal year 2004.

The graphs below show the major components of revenues and the cost of governmental activities for the year ended September 30, 2004.

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2004



FINANCIAL ANALYSIS OF YAP STATE'S FUNDS

As noted earlier, Yap State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. As of the end of fiscal year 2004, Yap State's governmental funds reported a combined fund balance of \$59.88 million, which represents an increase of \$1.30 million (or 2.4%) in comparison with fiscal year 2003. This increase is equally attributable to the surplus resulting from revenues exceeding expenditures and to the increase in value of Yap State's combined investments. Of this total combined fund balance, \$23.28 million is reserved to indicate that it is not available for new spending because it has already been committed: 1) to generate income for future operations (\$12.48 million); 2) to liquidate contracts and purchase orders of the prior period (\$5.98 million); 3) to fund specific general fund and compact CIP-related activities (\$4.19 million); or 4) for on-going capital projects (\$0.64 million). The unreserved combined fund balance is \$36.60 million, a decrease of \$5.54 million (or 13.1%) from fiscal year 2003. The decrease is mainly accounted for by the transfer-in of \$4.9 million to the Compact Trust Fund of previously unreserved general fund surpluses. The Compact Trust Fund, newly created in fiscal year 2004, is a restricted asset available to fund future operations.

YAP STATE GOVERNMENT

Management's Discussion and Analysis
Year Ending September 30, 2004

GENERAL FUND BUDGETARY HIGHLIGHTS

During fiscal year 2004, Yap State did not revise either its general fund revenue or expenditure budget. Various disbursements from the general fund were required to fund expenditures later covered by late-allotted Compact sector grants, but all were appropriately transferred to the sector grants during the year. Similarly, other general fund expenditures for typhoons Lupit and Sudal were able to be transferred to FEMA grants once they were received. Notwithstanding these extraordinary transactions, Yap State was able to maintain its budgetary stability throughout the year, resulting in a small \$1.74 million positive variance in the excess of revenues over expenditures.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Yap State's investment in capital assets for the primary government as of September 30, 2004, amounted to \$98.08 million, net of accumulated depreciation of \$61.41 million, leaving a net book value of \$36.67 million. This represents a net decrease of \$0.73 million (or 1.95%) from fiscal year 2003. No significant fixed asset additions or retirements occurred in fiscal year 2004, but construction in progress began on the Southern Yap Road which will be completed in fiscal year 2005 at an estimated \$3.9 million. The table below summarizes Yap State's capital assets:

Yap State's Capital Assets September 30, 2004

	<u>2004</u>	<u>2003</u>
Land	\$ 1,836,254	\$ 1,761,889
Construction in progress	563,842	-
Buildings	7,619,864	8,115,147
Equipment	137,445	-
Vehicles	199,895	248,343
Boats	12,615	8,820
Infrastructure	26,299,584	27,363,094
Other	175,792	241,786
	<u>\$36,845,291</u>	<u>\$37,739,079</u>

Additional information on Yap State's capital assets can be found in note 5 to the financial statements.

Long-Term Debt

Long-term debt obligations of the Yap State primary government total \$4.26 million at September 30, 2004; an amount virtually unchanged for the past several years. This debt is comprised of the ADB Early Retirement Program Loan (\$3.5), liability for compensated absences (\$0.51 million) and payments due under land purchase agreements (\$0.25 million). Principal payments on the outstanding ADB loan will not begin until 2008 and will be partially funded by \$2.3 million deposited in a restricted investment account jointly held with the FSM National Government.

YAP STATE GOVERNMENT

Management's Discussion and Analysis Year Ending September 30, 2004

Additional information on Yap State's long-term debt obligations can be found in note 7 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

A major hallmark of Yap State's financial management in fiscal year 2004 was its ability to maintain budget stability and a solid financial position even after the devastation caused by typhoons Lupit and Sudal. The reconstruction of significant portions of Yap's private and public facilities was primarily the result of grants from the Federal Emergency Management Agency (FEMA); funding which had a positive impact on the local economy in fiscal year 2004 and will continue in fiscal year 2005. Additionally in fiscal year 2005, Yap State will have a \$1 million National Emergency Grant from the U.S. Department of Labor with which to rebuild its communities. Both grant revenues and local revenues will receive a positive boost as a result.

Another positive development in fiscal year 2005 has been a favorable investment climate that has boosted Yap State's investment portfolio, resulting in \$6.5 million in investment earnings, compared to only \$3.1 million in FY-04. Because no transfer to the Compact trust fund is necessary in fiscal year 2005, in contrast to the \$4.9 million transferred in fiscal year 2004, the general fund unreserved fund surplus is expected to increase accordingly.

Certain matters related to the new fiscal provisions of the Compact remain problematic in fiscal year 2005 and will support Yap State's customary caution with respect to the budgeting and expenditure of Compact sector grants. The allotment of public infrastructure grants remains stalled because of implementation concerns of the U.S. Department of Interior. Likewise in fiscal year 2005, there has been delayed implementation by the United States of the Supplemental Education Grants (SEG).

Notwithstanding, these trends, Yap State will maintain its characteristic fiscal conservatism by undertaking no new major budget initiatives in fiscal year 2005 and continuing to maintain strict budget discipline. Expenditures will be kept within available local resources and targeted grant funding. As a result, management expects solid operating results and an even stronger financial position to materialize for Yap State at September 30, 2005.

CONTACTING YAP STATE'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors, a general overview of Yap State's finances to demonstrate its accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Director, Office of Administrative Services, P.O. Box 610, Yap, FM 96943.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
September 30, 2004

	Primary Government			Component Units
	Governmental Activities	Business-Type Activities	Total	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 1,177,568	\$ 45,541	\$ 1,223,109	\$ 1,883,087
Time certificates of deposit	-	-	-	1,566,000
Investments	54,159,836	-	54,159,836	395,274
Receivables, net of allowance for uncollectibles	2,223,350	5,272	2,228,622	458,297
Advances	319,574	-	319,574	-
Inventories	299,424	-	299,424	360,106
Other current assets	118,719	51,505	170,224	117,766
Total current assets	<u>58,298,471</u>	<u>102,318</u>	<u>58,400,789</u>	<u>4,780,530</u>
Noncurrent assets:				
Restricted assets:				
Cash and cash equivalents	2,297,587	-	2,297,587	-
Investments	2,500,000	-	2,500,000	-
Receivables	696,138	-	696,138	-
Capital assets, net of accumulated depreciation	36,669,499	175,792	36,845,291	13,577,135
Total noncurrent assets	<u>42,163,224</u>	<u>175,792</u>	<u>42,339,016</u>	<u>13,577,135</u>
Total assets	<u>\$ 100,461,695</u>	<u>\$ 278,110</u>	<u>\$ 100,739,805</u>	<u>\$ 18,357,665</u>
LIABILITIES				
Current liabilities:				
Current portion of long-term obligations	\$ -	\$ -	\$ -	\$ 154,564
Bank overdraft	282,651	-	282,651	-
Accounts payable	2,085,460	5,490	2,090,950	634,597
Compensated absences payable	85,655	-	85,655	-
Other liabilities and accruals	593,640	1,060	594,700	408,562
Deferred revenue	950,710	242	950,952	-
Total current liabilities	<u>3,998,116</u>	<u>6,792</u>	<u>4,004,908</u>	<u>1,197,723</u>
Noncurrent liabilities:				
Noncurrent portion of long-term obligations	3,500,000	-	3,500,000	3,930,500
Compensated absences payable	426,359	-	426,359	-
Other noncurrent liabilities	249,607	-	249,607	-
Total noncurrent liabilities	<u>4,175,966</u>	<u>-</u>	<u>4,175,966</u>	<u>3,930,500</u>
Total liabilities	<u>8,174,082</u>	<u>6,792</u>	<u>8,180,874</u>	<u>5,128,223</u>
NET ASSETS				
Invested in capital assets, net of related debt	36,669,499	175,792	36,845,291	10,458,428
Restricted for:				
Compact related	23,104,239	-	23,104,239	-
Future operations	5,400,000	-	5,400,000	-
Other purposes	448,691	-	448,691	277,769
Unrestricted	26,665,184	95,526	26,760,710	2,493,245
Total net assets	<u>92,287,613</u>	<u>271,318</u>	<u>92,558,931</u>	<u>13,229,442</u>
Total liabilities and net assets	<u>\$ 100,461,695</u>	<u>\$ 278,110</u>	<u>\$ 100,739,805</u>	<u>\$ 18,357,665</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Activities
Year Ended September 30, 2004

Functions/Programs	Program Revenues				Net (Expenses) Revenues and Changes in Net Assets			
	Expenses	Operating		Capital	Primary Government			Component Units
		Charges for Services	Grants and Contributions	Grants and Contributions	Governmental Activities	Business-type Activities	Total	
Primary government:								
Governmental activities:								
General government	\$ 3,951,061	\$ 377,620	\$ 1,874,541	\$ -	\$ (1,698,900)	\$ -	\$ (1,698,900)	\$ -
Health services	2,569,765	157,145	2,040,447	-	(372,173)	-	(372,173)	-
Education	4,230,554	8,646	4,003,188	-	(218,720)	-	(218,720)	-
Economic development	802,035	-	609,179	-	(192,856)	-	(192,856)	-
Public safety	709,102	-	449,114	-	(259,988)	-	(259,988)	-
Public works and transportation	3,766,157	131,320	515,484	36,564	(3,082,789)	-	(3,082,789)	-
Community affairs	574,651	-	-	-	(574,651)	-	(574,651)	-
Boards and commissions	580,117	-	302,338	-	(277,779)	-	(277,779)	-
Payments to components	572,664	-	102,954	-	(469,710)	-	(469,710)	-
Judiciary	210,270	-	209,667	-	(603)	-	(603)	-
Public auditor	87,748	-	93,684	-	5,936	-	5,936	-
Future operations	-	-	500,000	-	500,000	-	500,000	-
Capital projects	46,553	-	-	46,553	-	-	-	-
Other	536,223	36,794	151,057	-	(348,372)	-	(348,372)	-
Total governmental activities	18,636,900	711,525	10,851,653	83,117	(6,990,605)	-	(6,990,605)	-
Business-type activities:								
Public Transportation System	322,581	202,037	133,038	-	-	12,494	12,494	-
Total primary government	\$ 18,959,481	\$ 913,562	\$ 10,984,691	\$ 83,117	(6,990,605)	12,494	(6,978,111)	-
Component units:								
Yap Visitor's Bureau	\$ 495,350	\$ 444	\$ -	\$ -	-	-	-	(494,906)
Yap State Public Service Corporation	3,745,107	2,945,230	-	-	-	-	-	(799,877)
Yap Fishing Authority	514,688	160,075	-	189,767	-	-	-	(164,846)
The Diving Seagull, Inc.	4,420,443	4,452,272	-	-	-	-	-	31,829
Total component units	\$ 9,175,588	\$ 7,558,021	\$ -	\$ 189,767	-	-	-	(1,427,800)
General revenues:								
Taxes:								
Revenue sharing					2,433,187	-	2,433,187	-
Excise taxes					1,346,023	-	1,346,023	-
Unrestricted investment earnings					3,118,031	-	3,118,031	22,176
Contributions from primary government					-	-	-	742,252
Other					572,598	-	572,598	-
Total general revenues and transfers					7,469,839	-	7,469,839	764,428
Change in net assets					479,234	12,494	491,728	(663,372)
Net assets at the beginning of the year					91,808,379	258,824	92,067,203	13,892,814
Net assets at the end of the year					\$ 92,287,613	\$ 271,318	\$ 92,558,931	\$ 13,229,442

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Balance Sheet
Governmental Funds
September 30, 2004

	General	Special Revenue		Capital Projects	Permanent	Other Governmental Funds	Total
		U.S Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
ASSETS							
Cash and cash equivalents	\$ 1,022,377	\$ -	\$ -	\$ -	\$ -	\$ 155,191	\$ 1,177,568
Equity interest in internal investment pool	25,456,292	-	-	21,470,737	-	1,832,807	48,759,836
Investments	2,500,000	-	-	-	5,400,000	-	7,900,000
Receivables, net:							
Loans	758,210	-	-	-	-	-	758,210
Federal agencies	-	596,695	-	-	-	-	596,695
CFSM	-	382,061	202,601	-	-	33,793	618,455
Taxes	577,095	-	-	-	-	-	577,095
Other	344,531	-	-	-	-	24,502	369,033
Due from other funds	916,371	-	417,385	-	-	1,274,104	2,607,860
Advances	319,574	-	-	-	-	-	319,574
Prepaid items	118,719	-	-	-	-	-	118,719
Inventories	299,424	-	-	-	-	-	299,424
Restricted assets:							
Cash and cash equivalents	2,297,587	-	-	-	-	-	2,297,587
Total assets	\$ 34,610,180	\$ 978,756	\$ 619,986	\$ 21,470,737	\$ 5,400,000	\$ 3,320,397	\$ 66,400,056
LIABILITIES AND FUND BALANCES							
Liabilities:							
Bank overdraft	\$ 282,651	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 282,651
Accounts payable	1,331,885	72,589	170,064	148,926	-	361,996	2,085,460
Other liabilities and accruals	573,989	186	-	248	-	19,217	593,640
Deferred revenue	-	-	310,690	-	-	640,020	950,710
Due to other funds	1,691,489	753,032	139,168	-	-	24,171	2,607,860
Total liabilities	3,880,014	825,807	619,922	149,174	-	1,045,404	6,520,321
Fund balances (deficits):							
Reserved for:							
Related assets	7,081,805	-	-	-	5,400,000	-	12,481,805
Encumbrances	998,548	293,173	268,323	3,546,095	-	876,761	5,982,900
Continuing appropriations	1,825,524	-	-	2,212,715	-	150,000	4,188,239
Capital projects	637,993	-	-	-	-	-	637,993
Unreserved:							
General fund	20,186,296	-	-	-	-	-	20,186,296
Special revenue funds	-	(140,224)	(268,259)	-	-	1,358,899	950,416
Capital projects funds	-	-	-	15,562,753	-	(110,667)	15,452,086
Total fund balances	30,730,166	152,949	64	21,321,563	5,400,000	2,274,993	59,879,735
Total liabilities and fund balances	\$ 34,610,180	\$ 978,756	\$ 619,986	\$ 21,470,737	\$ 5,400,000	\$ 3,320,397	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds

36,669,499

Long-term liabilities, including loans payable, are not due and payable in the current period and, therefore, are not reported in the funds. The liabilities include:

 Long-term debt payable (3,500,000)
 Compensated absences payable (512,014)
 Land acquisition claims payable (249,607)

(4,261,621)

Net assets of governmental activities

\$ 92,287,613

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficits)
Governmental Funds
Year Ended September 30, 2004

	General	Special Revenue		Capital Projects	Permanent	Other Governmental Funds	Total
		U.S Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
Revenues:							
Compact funding	\$ -	\$ -	\$ 6,721,556	\$ -	\$ -	\$ -	\$ 6,721,556
Net increase in the fair value of investments	3,118,031	-	-	-	-	-	3,118,031
Federal contributions and other grants	-	2,308,083	-	-	500,000	1,182,532	3,990,615
Revenue sharing	2,433,187	-	-	-	-	-	2,433,187
Excise taxes	1,212,463	-	-	-	-	133,560	1,346,023
CFSM grants	-	-	-	-	-	222,599	222,599
Fees and charges	377,620	-	-	-	-	10,772	388,392
Departmental charges	323,133	-	-	-	-	-	323,133
Other	572,598	-	-	-	-	-	572,598
Total revenues	8,037,032	2,308,083	6,721,556	-	500,000	1,549,463	19,116,134
Expenditures:							
Current:							
General government	2,106,213	113,837	459,243	-	-	1,273,200	3,952,493
Health services	650,280	207,262	1,811,876	-	-	1,474	2,670,892
Education	138,642	1,206,310	2,796,878	-	-	44,333	4,186,163
Economic development	132,038	192,052	369,755	74,365	-	27,181	795,391
Public safety	244,602	-	429,648	-	-	19,466	693,716
Public works and transportation	1,662,243	349,400	118,777	593,739	-	494,377	3,218,536
Community affairs	257,399	-	-	-	-	-	257,399
Boards and commissions	276,794	-	302,338	-	-	-	579,132
Payments to component units	469,710	-	102,954	-	-	-	572,664
Judiciary	-	-	168,402	-	-	41,265	209,667
Public auditor	-	-	93,684	-	-	-	93,684
Other	228,682	81,924	67,937	-	-	157,680	536,223
Capital projects	-	-	-	-	-	46,553	46,553
Total expenditures	6,166,603	2,150,785	6,721,492	668,104	-	2,105,529	17,812,513
Excess (deficiency) of revenues over (under) expenditures	1,870,429	157,298	64	(668,104)	500,000	(556,066)	1,303,621
Other financing sources (uses):							
Operating transfers in	-	-	-	-	4,900,000	597,273	5,497,273
Operating transfers out	(597,273)	-	-	(4,900,000)	-	-	(5,497,273)
Total other financing sources (uses), net	(597,273)	-	-	(4,900,000)	4,900,000	597,273	-
Net change in fund balances	1,273,156	157,298	64	(5,568,104)	5,400,000	41,207	1,303,621
Fund balances (deficits) at the beginning of the year	29,457,010	(4,349)	-	26,889,667	-	2,233,786	58,576,114
Fund balances at the end of the year	\$ 30,730,166	\$ 152,949	\$ 64	\$ 21,321,563	\$ 5,400,000	\$ 2,274,993	\$ 59,879,735

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
Year Ended September 30, 2004

Amounts reported for governmental activities in the statement of activities on page 11 are different because:

Net change in fund balances - total governmental funds from page 13	\$ 1,303,621
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation exceeded capital outlays in the current period, including increases to construction in progress	(827,794)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in governmental funds. These expenses include accrued annual leave and land claims payable that are reported in the statement of activities, but not in funds	<u>3,407</u>
Change in net assets of governmental activities as presented on page 11.	\$ <u>479,234</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Net Assets
Proprietary Funds
September 30, 2004

	<u>Public Transportation System</u>
<u>ASSETS</u>	
Current assets:	
Cash and cash equivalents	\$ 45,541
Receivables, net of allowance for uncollectibles	5,272
Other current assets	<u>51,505</u>
Total current assets	<u>102,318</u>
Noncurrent assets:	
Capital assets, net of accumulated depreciation	<u>175,792</u>
Total assets	<u>\$ 278,110</u>
<u>LIABILITIES</u>	
Current liabilities:	
Accounts payable	\$ 5,490
Other liabilities and accruals	1,060
Deferred revenue	<u>242</u>
Total liabilities	<u>6,792</u>
<u>NET ASSETS</u>	
Invested in capital assets, net of related debt	175,792
Unrestricted	<u>95,526</u>
Total net assets	<u>271,318</u>
	<u>\$ 278,110</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenses, and Changes in Net Assets
Proprietary Funds
Year Ended September 30, 2004

	<u>Public Transportation System</u>
Operating revenues:	
Charges for services	\$ 133,156
Sales	77,442
Other	7,431
Total operating revenues	<u>218,029</u>
Operating expenses:	
Cost of services	33,917
Administration costs	221,257
Depreciation and amortization	67,407
Total operating expenses	<u>322,581</u>
Operating loss	<u>(104,552)</u>
Nonoperating revenues (expenses):	
Other	(15,992)
Total nonoperating expenses	<u>(15,992)</u>
Loss before operating transfers	(120,544)
Operating transfers in	<u>133,038</u>
Change in net assets	12,494
Net assets at the beginning of the year	<u>258,824</u>
Net assets at the end of the year	<u>\$ 271,318</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Cash Flows
Proprietary Funds
Year Ended September 30, 2004

	<u>Public Transportation System</u>
Cash flows from operating activities:	
Cash received from customers	\$ 156,668
Cash payments to employees	(147,369)
Cash payments to suppliers	<u>(131,694)</u>
Net cash used in operating activities	<u>(122,395)</u>
Cash flows from noncapital financing activities:	
Contributions from the primary government	<u>133,038</u>
Net cash provided by noncapital financing activities	<u>133,038</u>
Cash flows from capital and related financing activities:	
Purchases of capital assets	<u>(12,771)</u>
Net cash used in capital and related financing activities	<u>(12,771)</u>
Net change in cash and cash equivalents	(2,128)
Cash and cash equivalents at the beginning of the year	<u>47,669</u>
Cash and cash equivalents at the end of the year	<u><u>\$ 45,541</u></u>
Reconciliation of operating loss to net cash used in operating activities:	
Operating loss	\$ (104,552)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	67,407
Bad debts expense	1,797
Changes in assets and liabilities:	
Receivables, net	6,964
Other current assets	(16,324)
Accounts payable	(15,248)
Other liabilities and accruals	(5,525)
Deferred revenue	<u>(56,914)</u>
Net cash used in operating activities	<u><u>\$ (122,395)</u></u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Statement of Net Assets
Component Units
September 30, 2004

	Yap Visitor's Bureau	Yap State Public Service Corporation	Yap Fishing Authority	The Diving Seagull, Inc.	Total
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 191,723	\$ 733,733	\$ 77,560	\$ 880,071	\$ 1,883,087
Time certificate of deposit	-	-	-	1,566,000	1,566,000
Investments	-	-	395,274	-	395,274
Receivables, net:					
General	-	388,101	5,870	-	393,971
Other	5,924	34,609	10,278	13,515	64,326
Inventories	-	360,106	-	-	360,106
Other current assets	9,580	-	69,220	38,966	117,766
Total current assets	<u>207,227</u>	<u>1,516,549</u>	<u>558,202</u>	<u>2,498,552</u>	<u>4,780,530</u>
Noncurrent assets:					
Capital assets, net of accumulated depreciation	31,753	10,323,911	2,039,143	1,182,328	13,577,135
Total noncurrent assets	<u>31,753</u>	<u>10,323,911</u>	<u>2,039,143</u>	<u>1,182,328</u>	<u>13,577,135</u>
Total assets	<u>\$ 238,980</u>	<u>\$ 11,840,460</u>	<u>\$ 2,597,345</u>	<u>\$ 3,680,880</u>	<u>\$ 18,357,665</u>
LIABILITIES					
Current liabilities:					
Current portion of long-term debt	\$ -	\$ 62,072	\$ -	\$ 92,492	\$ 154,564
Accounts payable	17,750	302,380	19,998	294,469	634,597
Other liabilities and accruals	10,360	186,359	79,105	132,738	408,562
Total current liabilities	<u>28,110</u>	<u>550,811</u>	<u>99,103</u>	<u>519,699</u>	<u>1,197,723</u>
Noncurrent liabilities:					
Noncurrent portion of long-term debt	-	3,056,635	-	873,865	3,930,500
Total liabilities	<u>28,110</u>	<u>3,607,446</u>	<u>99,103</u>	<u>1,393,564</u>	<u>5,128,223</u>
NET ASSETS					
Invested in capital assets, net of related debt	31,753	7,205,204	2,039,143	1,182,328	10,458,428
Restricted	-	277,769	-	-	277,769
Unrestricted	179,117	750,041	459,099	1,104,988	2,493,245
Total net assets	<u>210,870</u>	<u>8,233,014</u>	<u>2,498,242</u>	<u>2,287,316</u>	<u>13,229,442</u>
	<u>\$ 238,980</u>	<u>\$ 11,840,460</u>	<u>\$ 2,597,345</u>	<u>\$ 3,680,880</u>	<u>\$ 18,357,665</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Statement of Revenues, Expenses, and Changes in Net Assets
Component Units
Year Ended September 30, 2004

	Yap Visitor's Bureau	Yap State Public Service Corporation	Yap Fishing Authority	The Diving Seagull, Inc.	Total
Operating revenues:					
Charges for services	\$ -	\$ 2,546,288	\$ 70,434	\$ 2,144	\$ 2,618,866
Sales	444	398,942	89,641	4,450,128	4,939,155
Total operating revenues	<u>444</u>	<u>2,945,230</u>	<u>160,075</u>	<u>4,452,272</u>	<u>7,558,021</u>
Operating expenses:					
Cost of services	-	2,994,620	9,068	3,505,893	6,509,581
Administration costs	474,714	227,543	192,973	556,300	1,451,530
Depreciation and amortization	14,083	737,627	182,184	9,737	943,631
Total operating expenses	<u>488,797</u>	<u>3,959,790</u>	<u>384,225</u>	<u>4,071,930</u>	<u>8,904,742</u>
Operating income (loss)	<u>(488,353)</u>	<u>(1,014,560)</u>	<u>(224,150)</u>	<u>380,342</u>	<u>(1,346,721)</u>
Nonoperating revenues (expenses):					
Contributions from the primary government	661,252	-	81,000	-	742,252
Interest income	-	12,032	-	10,144	22,176
Interest expense	-	(20,092)	-	(68,295)	(88,387)
Other	(6,553)	234,775	(130,463)	(280,218)	(182,459)
Total nonoperating revenues (expenses), net	<u>654,699</u>	<u>226,715</u>	<u>(49,463)</u>	<u>(338,369)</u>	<u>493,582</u>
Capital contributions	-	-	189,767	-	189,767
Net income (loss)	166,346	(787,845)	(83,846)	41,973	(663,372)
Net assets at the beginning of the year	44,524	9,020,859	2,582,088	2,245,343	13,892,814
Net assets at the end of the year	<u>\$ 210,870</u>	<u>\$ 8,233,014</u>	<u>\$ 2,498,242</u>	<u>\$ 2,287,316</u>	<u>\$ 13,229,442</u>

See accompanying notes to financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies

The accompanying financial statements of the State of Yap (the State) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the State's accounting policies are described below.

A. Reporting Entity

The State is one of the four states that make up the Federated States of Micronesia (FSM), along with the states of Chuuk, Kosrae and Pohnpei. The State is a constitutional government comprised of three branches: the Legislative Branch, consisting of 10 members elected for a term of four years by qualified voters of their respective election districts; the Executive Branch, headed by the Governor and Lt. Governor who are primarily responsible for executing the laws and administering state government services; and the Judiciary Branch made up of the State Supreme Court, which consists of a Chief Justice and two Associate Justices, and other courts that may be created by law. The State also has traditional leaders that serve in the Council of Pilung and the Council of Tamol that advise the State on matters concerning customary law and traditional practice.

For financial reporting purposes, the State has included all funds, organizations, agencies, boards, commissions and institutions. The State has also considered all potential component units for which it is financially accountable as well as other entities for which the nature and significance of their relationship with the State are such that exclusion would cause the State's financial statements to be misleading or incomplete. The criteria to be considered in determining financial accountability include whether the State, as the primary government, has appointed a voting majority of an organization's governing body and either has the ability to impose its will on that organization or there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the State. Financial accountability also exists if an organization is determined to be fiscally dependent on the primary government, although the primary government does not appoint a voting majority of the organization's governing board.

Each blended and discretely presented component unit of the State has a September 30 year-end.

Once financial accountability has been determined for a potential component unit, that component unit is either blended into the primary government or discretely presented from the primary government. Potential component units that do not meet the financial accountability criteria, but where a voting majority of the governing board is appointed by the State, are deemed to be related organizations. The nature and relationship of the State's component units and related organizations are disclosed in the following section.

Blended component units are entities that are legally separate from the State, but are so related to the State that they are, in substance, the same as the State or entities providing services entirely or almost entirely to the State. The net assets and results of operations of the following legally separate entities are presented as part of the State's operations:

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

i. Blended Component Units

The following Component Unit is blended within the Primary Government:

Public Transportation System (PTS), a Proprietary Fund Type - Enterprise Fund. This fund was created by Yap State Law (YSL) No. 1-170 and is responsible for the provision of reliable and inexpensive transportation for those people living outside of the Colonia area. PTS is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

ii. Discretely Presented Component Units

Discretely presented component units are entities which are legally separate from the State, but are financially accountable to the State, or whose relationships with the State are such that exclusion would cause the State's basic financial statements to be misleading or incomplete. The component units' column of the basic financial statements includes the financial data of the following major component units:

Yap Visitor's Bureau (YVB): YVB was created by YSL No. 4-25 and is responsible for the promotion of Yap as a tourist destination. YVB is governed by a seven-member Board of Directors, of which five members are appointed by the Governor subject to the advice and consent of the Legislature, one member is appointed by the Speaker of the Legislature, and one member is elected by the six appointed members.

Yap State Public Service Corporation (YSPSC): YSPSC was created by YSL No. 4-4 and is responsible for the delivery of electricity, water and sewer in the State. YSPSC is governed by a seven-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

Yap Fishing Authority (YFA): YFA was created by Yap District Law (YDL) No. 6-13 and is responsible for the promotion, development, and supporting of commercial utilization of living marine resources within the State. YFA is governed by a five-member Board of Directors appointed by the Governor subject to the advice and consent of the Legislature.

The Diving Seagull, Inc. (DSI): DSI was incorporated in the State on March 17, 1997 and was organized primarily to pursue fishing and other fishing related activities by operating fishing vessels, marketing and selling fish, and developing cold storage and/or transshipment facilities. DSI is governed by a seven-member Board of Directors.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

A. Reporting Entity, Continued

ii. Discretely Presented Component Units, Continued

The State's component units, departments, and funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities or obtaining them directly from the Office of the Public Auditor at the following address.

P.O. Box 927
Colonia, Yap, FSM 96943

iii. Omitted Component Units

The following component units have been omitted from the basic financial statements due to the lack of available financial information:

Gagil-Tomil Water Authority (GTWA): GTWA was created by YSL No. 1-183 and is responsible for the provision of services in the operation and maintenance of the Gagil-Tomil Water System. GTWA is governed by a nine-member Board of Directors, four of which are appointed by the Gagil member of the Council of Pilung, four appointed by the Tomil member of the Council of Pilung, and one appointed by the Governor. The financial activities of this omitted component unit are not considered material to the basic financial statements.

Southern Yap Water Authority (SYWA): SYWA was created by YSL No. 1-221 and is responsible for the operation and maintenance of the Southern Yap Water System. SYWA is governed by a six-member Board of Directors, of which one is appointed by the Governor, two members who are appointed by the Municipal Chief of Rull on the Council of Pilung, one of whom shall be from either Lamer or Luwech Villages, and three members who are appointed by the municipal chiefs of Gilman, Kanifay, and Dalipebinaw on the Council of Pilung. The financial activities of this omitted component unit are not considered material to the basic financial statements.

Yap Sports Council (YSC): YSC was created by YSL No. 4-65 and is responsible for promoting and encouraging sports participation at all levels of society. YSC is governed by an eleven-member Board of Directors, of which three members are appointed by the Governor subject to the advice and consent of the Legislature, two members are appointed by the Speaker of the Legislature, two members are appointed by the Council of Pilung, two members are appointed by the Council of Tamol, and two members are appointed by the Congress of the FSM National Government. The financial activities of this omitted component unit are not considered material to the basic financial statements.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

B. Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities report financial information on all of the non-fiduciary activities of the primary government and its component units. For the most part, the effect of interfund activity has been eliminated from these statements except for other charges between the primary government and the discretely presented component units. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

Primary government activities are defined as either governmental or business-type activities. Governmental activities, which normally are supported by taxes, intergovernmental revenues and other non-exchange revenues, are reported separately from business-type activities, which rely to a significant extent on fees charged to external parties for goods or services. As such, business-type activities account for operations similarly to a for-profit business. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable. Discretely presented component unit activities are presented with their business-type focus.

The Statement of Net Assets presents all of the reporting entity's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- Restricted net assets result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law.
- Unrestricted net assets consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, (for example, internally restricted), to indicate that management does not consider them to be available for general operations.

The government-wide Statement of Net Assets reports \$28,952,930 of restricted net assets, of which \$448,691 is restricted by enabling legislation.

The Statement of Activities demonstrates the degree to which the direct expenses of given functions or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are, instead, reported as general revenue.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

C. Fund Financial Statements

The fund financial statements present a balance sheet and a statement of revenues, expenditures, and changes in fund balances for its major and aggregated non-major funds.

Major individual governmental funds are reported as separate columns in the fund financial statements pursuant to GASB reporting standards, with nonmajor governmental funds being combined into a single column.

The State reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

D. Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements account for the general governmental activities of the State and are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual; generally when they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the State considers revenues to be available if they are collected within sixty days of the end of the current fiscal period.

Significant revenues susceptible to accrual include income and gross revenue taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Miscellaneous revenues from other financing sources are recognized when received in cash because they are generally not measurable until actually received. Investment earnings are recorded as earned, since they are both measurable and available. Investments and related investment earnings are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Expenditures generally are recorded in the period in which the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

Amounts reported as program revenue include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. General revenue is derived from taxation, investment income and other fees that are not allocated to specific programs.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All other revenues are reported as nonoperating. Operating expenses includes the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The State reports the following fund types:

1. Governmental Funds

i. General Fund

This fund is the primary operating fund of the State. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

ii. Special Revenue Funds

These funds account for specific revenue sources that have been aggregated according to enabling legislation to support specific governmental activities.

iii. Capital Projects Funds

These funds account for the acquisition or construction of major State capital facilities financed primarily from loans and federal reimbursements.

iv. Permanent Fund

This fund accounts for resources that are legally restricted to the extent that only earnings, and not principal, may be used to support programs for the benefit of the government.

2. Proprietary Funds

i. Enterprise Fund

This fund accounts for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

D. Measurement Focus and Basis of Accounting, Continued

GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - Omnibus*, sets forth minimum criteria (percentage of the assets, liabilities, revenues or expenditures/expenses for either fund category or the governmental and enterprise combined) for the determination of major funds. Major individual governmental funds are reported as separate columns in the fund financial statements. The nonmajor funds are combined in a column in the fund financial statements and detailed in the combining statements. The State reports the following major funds:

U.S. Federal Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for all financial transactions formally related to the Trust Territory of the Pacific Islands (TTPI) United States federally assisted funds, which are subgranted to the State, as well as other direct federal grants that the State received from the United States government once the State's subgrantee status with the TTPI ceased.

Compact Sector Grants Fund, a Governmental Fund Type - Special Revenue Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(a) and approved by the FSM Congress to promote economic advancement and budgetary self-reliance. These appropriations are to be used for assistance in education, health care, the environment, public sector capacity building, and private sector development, or for other areas as mutually agreed, with priorities in the education and health care sectors.

Compact Capital Projects Fund, a Governmental Fund Type - Capital Projects Fund. This fund is used to account for financial transactions related to Compact Capital Account funds as provided under Section 211(a) of the Compact of Free Association.

Compact Trust Fund, a Governmental Fund Type - Permanent Fund. This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 215 and approved by the FSM Congress to provide for an additional source of revenue for the government budget that will be needed to substitute for the absence of Compact of Free Association funding. Earnings from funds invested would not be available for distribution until October 2023.

E. Reporting Standards

As allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the State's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

F. Cash and Cash Equivalents and Time Certificates of Deposit

The State pools cash resources of its various funds in order to facilitate the management of cash. Unless otherwise required by law, interest income received on pooled cash accrues to the General Fund. Cash and cash equivalents applicable to a particular fund are readily identifiable. Cash and cash equivalents include cash held in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the State. Deposits maintained in time certificates of deposit with original maturity dates greater than ninety days are separately classified on the statement of net assets/balance sheet.

As of September 30, 2004, the carrying amount of the primary government's total cash and cash equivalents and time certificates of deposit were \$3,520,696 and the corresponding bank balances were \$3,934,470. Of the bank balance amounts, all cash is maintained in financial institutions subject to Federal Deposit Insurance Corporation (FDIC) insurance. As of September 30, 2004, bank deposits in the amount of \$200,000 were FDIC insured. The State does not require collateralization of its cash deposits; therefore, deposit levels in excess of FDIC insurance coverage are uncollateralized.

G. Investments

Investments are recorded at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. When market prices of equity investments in companies are not readily determinable, the investments are carried at cost if less than twenty percent of the companies' total equity is owned, on the equity method if greater than twenty percent and less than fifty percent is owned, and on a consolidated basis if greater than fifty percent is owned.

H. Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental fund financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the State for expenditures on federally funded reimbursement and grant programs are reported as "receivables from federal agencies".

Receivables of the primary government are primarily due from businesses and individuals residing in the State. The allowance for uncollectible accounts primarily represents those accounts that are more than ninety days delinquent as of September 30, 2004.

I. Prepaid Items and Inventories

Certain payments made to vendors or persons for services reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Inventories of the Primary Government and Component Units are determined by physical count and are valued at the lower of cost or market by the first-in first-out method (FIFO).

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

J. Interfund Receivables/Payables

During the course of its operations, the State records transactions between individual funds for goods provided or services rendered. Receivables and payables resulting from transactions between funds are classified as "due from other funds" or "due to other funds" on the governmental fund balance sheet.

These balances result from the time lag between the dates that 1) interfund goods and services are provided or reimbursable expenditures occur, 2) transactions are recorded in the accounting system, and 3) payments between funds are made, and are scheduled to be collected in the subsequent year.

K. Restricted Assets

Certain assets of the primary government are classified as restricted assets because their use is completely restricted through loan agreements or enabling legislation. Specifically, the State has collateralized Asian Development Bank loan proceeds and earnings in the amount of \$2,297,587 for the Yap State Early Retirement Scheme.

L. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets (e.g. roads, bridges, docks, water and sewer lines, water catchments, and other similar items), are reported in the governmental activity column of the government-wide financial statements. Such assets, whether purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at estimated fair market value at the date of donation.

The State currently holds no title to land. Machinery and equipment, other than vehicles and boats, are capitalized when the cost of individual items exceed \$50,000. Vehicles and boats, along with significant repair and maintenance qualifying as a betterment of such, are capitalized regardless of cost and depreciated. Buildings and infrastructure projects, along with significant improvements or reconstruction qualifying as a betterment of such, are capitalized when the cost of individual items or projects exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of the capital asset or materially extend capital asset lives are not capitalized.

Capital assets of the primary government and the component units are depreciated using the straight-line method over their estimated useful lives, with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

Buildings	40 - 50 years
Infrastructure	25 - 50 years
Facilities	3 - 40 years
Machinery and equipment	3 - 25 years
Furniture and fixtures	3 - 10 years

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

M. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated in the government-wide financial statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and, 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

N. Deferred Revenue

In the government-wide financial statements, deferred revenue is recognized when cash, receivables or other assets are recorded prior to being earned. In the governmental fund financial statements deferred revenue represents monies received or revenues accrued which have not been earned or do not meet the "available" criterion for revenue recognition under the modified accrual basis of accounting. The deferred revenue in the governmental fund types has primarily resulted as federal funds are received in advance of eligible expenditures.

O. Compensated Absences

It is the government's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the government does not have a policy to pay any amounts when employees separate from service with the government. All vacation pay is accrued when incurred in the government-wide financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements. Annual leave accumulates at the rate of one working day per bi-weekly pay period.

P. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

P. Fund Equity, Continued

The unreserved fund balances for the governmental funds represent the amount available for budgeting future operations. The reserve for related assets as of September 30, 2004, is represented by the following assets:

	<u>General</u>	<u>U.S. Federal Grants</u>	<u>U.S. Federal Grants</u>	<u>Compact Capital Projects</u>	<u>Compact Trust</u>	<u>Other Governmental Funds</u>	<u>Totals</u>
Equity interest in internal investment pool	\$ 1,202,413	\$ -	\$ -	\$ -	\$ 5,400,000	\$ -	\$ 6,602,413
Investments	2,500,000	-	-	-	-	-	2,500,000
Receivables:							
Loans	758,210	-	-	-	-	-	758,210
Due from other funds	24,171	-	-	-	-	-	24,171
Inventories	299,424	-	-	-	-	-	299,424
Restricted assets:							
Cash and cash equivalents	<u>2,297,587</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,297,587</u>
	<u>\$ 7,081,805</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,400,000</u>	<u>\$ -</u>	<u>\$ 12,481,805</u>

The reserve for related assets within the General Fund includes the amount of \$3,500,000 set aside for future repayment of the Early Retirement Program Loan.

Q. Risk Financing

The State is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. It is the policy of the primary government not to purchase commercial insurance for the risks of loss to which it is exposed. Instead, the State management believes it is more economical to manage its risks internally. In the event of claim settlements and judgments, the State reports all of its risk management activities in its General Fund. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported.

R. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenditures and expenses during the reporting period. Actual results could differ from those estimates.

S. New Accounting Standards

During fiscal year 2004, the State implemented GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units (an amendment of GASB Statement 14)*. GASB Statement No. 39 provides additional guidance on GASB Statement No. 14, in determining whether an entity should be reported as a component unit based on the nature and significance of its relationship with a primary government.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(1) Summary of Significant Accounting Policies, Continued

S. New Accounting Standards, Continued

For fiscal year 2005, the State will be implementing GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment of GASB Statement No. 3)*, and GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, GASB Statement No. 40 addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest risk, GASB Statement No. 40 requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. GASB Statement No. 42 establishes standards for impairment of capital assets when service utility has declined significantly and unexpectedly. Management does not believe that the implementation of these Statements will have a material effect on the financial statements of the State.

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment to NCGA Statement 1*. GASB Statement No. 44 improves the understandability and usefulness of statistical section information and adds information from the new financial reporting model for state and local governments required by GASB Statement No. 34. The provisions of this Statement are effective for periods beginning after June 15, 2005. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB Statement No. 45 establishes standards for the measurement, recognition, and display of other postemployment benefits expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The provisions of this Statement are effective for periods beginning after December 15, 2008. Management does not believe that the implementation of this Statement will have a material effect on the financial statements of the State.

T. Restatement of Primary Government Governmental Activities Net Assets

Net assets, as previously reported September 30, 2003,	\$ 91,367,453
Understatement of capital assets, net of accumulated depreciation, previously reported for governmental activities	<u>440,926</u>
Net assets, as restated September 30, 2003	\$ <u>91,808,379</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(2) Investments

The State has invested the majority of its excess Compact Funds in a pooled investment fund which is managed under the control of the Federated Development Authority, an entity comprised of the FSM National Government and its four component states. Investment income originating from the pool accrues to the general fund.

The Federated Development Authority has selected investment managers who are given authority to buy and sell securities as follows:

- A. Investment managers may invest in stocks, bonds and cash equivalents. Minimum standards of quality for investments at the time of purchase shall be:

Cash and cash equivalents - The manager may engage in all normally accepted short-term investment practices including, but not limited to U.S. Treasury and Agency securities, bankers acceptances, certificates of deposit, commercial paper and repurchase agreements using any of the foregoing as collateral. The following restrictions apply: (1) Commercial paper must be rated A-1/P-1 or higher by Standard & Poors Corporation and Moody's Investor Services; and (2) Certificates of deposit must be from FDIC insured banks or FSLIC insured savings and loan associations, both of which must have assets in excess of two billion dollars. Deposits in smaller institutions are acceptable, but must not exceed the amount of the insurance, unless collateralized by U.S. Treasury Securities at 102%.

Stocks - A "B" rating by a national rating service. Non-rated stocks, such as banks or insurance companies, must be equal in quality or higher.

Bonds - Confined to issues rated "A" or higher by a national rating service, except in the case of U.S. Treasury or Agency Securities which are not rated.

- B. The equity portfolio shall be diversified among issues and industry classifications. No more than 25% of the equity portfolio may be invested in any single classification, as described by the Standard and Poors 500 Index, unless prior approval is received from the Secretary of Finance.
- C. No investment may be made in a single corporate entity which exceeds 5% of the total assets of the fund at the time of purchase without prior approval of the Secretary of Finance.

GASB Statement No. 3 requires government entities to categorize investments to give an indication of the level of credit risk assumed by the entity at year end. The three categories are described below:

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(2) Investments, Continued

- Category 1 Insured or registered, or securities held by the State or its agent in the State's name;
- Category 2 Uninsured and unregistered, with securities held by the broker's or dealer's trust department or agent in the State's name; or
- Category 3 Uninsured and unregistered, with securities held by the broker or dealer, or by its trust department or agent but not in the State's name.

Investments of the primary government and the discretely presented component units as of September 30, 2004, are as follows:

Primary Government

	<u>Categories</u>			<u>Carrying Value</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
Common stock	\$ 2,500,000	\$ 28,615,412	\$ -	\$ 31,115,412
U.S. Government agencies	-	10,413,167	-	10,413,167
Corporate notes and bonds	-	2,926,793	-	2,926,793
U.S. Government notes and bonds	-	2,285,944	-	2,285,944
Municipal obligations	-	146,288	-	146,288
	<u>\$ 2,500,000</u>	<u>\$ 44,387,604</u>	<u>\$ -</u>	46,887,604
Money market funds				<u>9,666,674</u>
				56,554,278
Due from brokers				<u>105,558</u>
				<u>\$ 56,659,836</u>

As of September 30, 2004, the General Fund holds 10.7% of the shares of the Bank of the Federated States of Micronesia in the amount of \$1,000,000, 24.5% of the shares of the Pacific Islands Development Bank in the amount of \$1,000,000, and an uncertain percentage of the shares of Palau Micronesia Air in the amount of \$500,000. As the fair market value of these investments is not readily available, such have been recorded at cost.

Discretely Presented Component Units

The Yap Fishing Authority (YFA) investment represents a 50% interest in Yap Fresh Tuna, Inc., an unconsolidated entity that should be consolidated into YFA in accordance with accounting principles generally accepted in the United States of America.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(3) Receivables

Receivables as of September 30, 2004, for the primary government's individual major funds and nonmajor funds in the aggregate, including applicable allowances for uncollectible accounts, are as follows:

	<u>General</u>	U.S. Federal <u>Grants</u>	Compact Sector <u>Grants</u>	Compact Capital <u>Projects</u>	Compact Trust	Public Transportation <u>System</u>	Nonmajor And Other <u>Funds</u>	<u>Totals</u>
Receivables:								
Loans	\$ 8,158,210	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 2,000,000	\$ 10,158,210
Federal agencies	-	596,695	-	-	-	-	-	596,695
CFSM	572,095	1,136,971	202,601	-	-	-	2,366,190	4,277,857
Taxes	359,437	-	-	-	-	-	-	359,437
Accrued interest	324,101	-	-	-	-	-	-	324,101
Other	<u>344,531</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>75,985</u>	<u>24,502</u>	<u>445,018</u>
	9,758,374	1,733,666	202,601	-	-	75,985	4,390,692	16,161,318
Less: allowance for uncollectible accounts	<u>(8,078,538)</u>	<u>(754,910)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(70,713)</u>	<u>(4,332,397)</u>	<u>(13,236,558)</u>
Net receivables	<u>\$ 1,679,836</u>	<u>\$ 978,756</u>	<u>\$ 202,601</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,272</u>	<u>\$ 58,295</u>	<u>\$ 2,924,760</u>

Loans receivable of the primary government as of September 30, 2004 are as follows:

Major Governmental Funds

General Fund:

Note receivable from the Yap Fishing Corporation, appropriated under YSL No. 2-96, uncollateralized, due and payable on or before June 11, 2004. This note has been fully provided for in the allowance for uncollectibles. \$ 6,400,000

Note receivable from the Yap Fishing Corporation, appropriated under YSL No. 3-8, uncollateralized, due September 30, 2004, interest at 6% per annum. This note has been fully provided for in the allowance for uncollectibles. 1,000,000

Note receivable from the Yap State Public Service Corporation, uncollateralized, due in quarterly interest only payments through March 2003; monthly principal and interest payments of \$5,651 starting June 1, 2003; interest at 2%, maturing in May 2017. 758,210

8,158,210

Nonmajor Governmental Funds

Note receivable from the Yap Fishing Corporation, appropriated under YSL No. 3-67, uncollateralized, non-interest bearing and payable on demand. This note has been fully provided for in the allowance for uncollectibles. 2,000,000

\$ 10,158,210

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(4) Interfund Receivables and Payables

Receivables and payables between funds reflected as due to/from other funds in the combined balance sheet at September 30, 2004, are summarized as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General	U.S. Federal Grants	\$ 753,032
General	Compact Sector Grants	139,168
General	Nonmajor governmental funds	24,171
Compact Sector Grants	General	417,385
Nonmajor governmental funds	General	1,274,104
		<u>\$ 2,607,860</u>

(5) Fixed Assets

Capital asset activities of the primary government for the year ended September 30, 2004, are as follows:

	<u>Balance October 1, 2003</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance September 30, 2004</u>
Governmental activities:				
Capital assets, not being depreciated:				
Land	\$ 1,761,889	\$ 74,365	\$ -	\$ 1,836,254
Construction in progress	-	563,842	-	563,842
	<u>1,761,889</u>	<u>638,207</u>	<u>-</u>	<u>2,400,096</u>
Capital assets, being depreciated:				
Buildings	12,611,120	-	-	12,611,120
Heavy equipment	2,350,696	140,918	-	2,491,614
Vehicles	529,726	15,276	-	545,002
Boats	1,207,100	8,000	-	1,215,100
Infrastructure	78,818,522	-	-	78,818,522
Total capital assets, being depreciated	<u>95,517,164</u>	<u>164,194</u>	<u>-</u>	<u>95,681,358</u>
Less accumulated depreciation for:				
Buildings	(4,495,973)	(495,283)	-	(4,991,256)
Heavy equipment	(2,350,696)	(3,473)	-	(2,354,169)
Vehicles	(281,383)	(63,724)	-	(345,107)
Boats	(1,198,280)	(4,205)	-	(1,202,485)
Infrastructure	(51,455,428)	(1,063,510)	-	(52,518,938)
	<u>(59,781,760)</u>	<u>(1,630,195)</u>	<u>-</u>	<u>(61,411,955)</u>
Total capital assets, being depreciated, net	<u>35,735,404</u>	<u>(1,466,001)</u>	<u>-</u>	<u>34,269,403</u>
Governmental activities capital assets, net	<u>\$ 37,497,293</u>	<u>\$ (827,794)</u>	<u>\$ -</u>	<u>\$ 36,669,499</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(5) Fixed Assets, Continued

	Balance October 1, 2003	<u>Additions</u>	<u>Retirements</u>	Balance September 30, 2004
Business-type activities:				
Capital assets, being depreciated:				
Buildings	\$ 92,659	\$ -	\$ (58,003)	\$ 34,656
Vehicles	718,707	3,900	(6,396)	716,211
Other equipment	<u>90,175</u>	<u>8,871</u>	<u>(10,512)</u>	<u>88,534</u>
Total capital assets, being depreciated	901,541	12,771	(74,911)	839,401
Less accumulated depreciation	<u>(659,755)</u>	<u>(67,407)</u>	<u>63,553</u>	<u>(663,609)</u>
Business-type activities capital assets, net	<u>\$ 241,786</u>	<u>\$ (54,636)</u>	<u>\$ (11,358)</u>	<u>\$ 175,792</u>

Depreciation expense was charged to functions/programs of the primary government's governmental activities as follows:

General government	\$ 37,394
Health services	12,372
Education	47,936
Economic development	81,009
Public safety	15,386
Public works and transportation	1,111,463
Community affairs	317,252
Boards and commissions	5,980
Judiciary	603
Public auditor	<u>800</u>
	<u>\$ 1,630,195</u>

(6) Operating Transfers In/Out

Operating transfers in/out for each major governmental fund and nonmajor governmental funds in the aggregate, for the year ended September 30, 2004, are as follows:

<u>Source</u>	<u>Recipient</u>	<u>Transfers Out</u>	<u>Transfers In</u>
<u>Major Governmental Funds</u>			
Compact Capital Projects	Compact Trust	\$ 4,900,000	\$ 4,900,000
General	Nonmajor governmental funds	<u>597,273</u>	<u>-</u>
General	Nonmajor governmental funds	<u>\$ 5,497,273</u>	<u>\$ 4,900,000</u>
<u>Nonmajor Governmental Funds</u>			
General	Nonmajor governmental funds	<u>\$ -</u>	<u>\$ 597,273</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(6) Operating Transfers In/Out, Continued

Transfers are used to: 1) move revenues from the fund that enabling legislation or budget requires to collect them to the fund that enabling legislation or budget requires to expend them, 2) use unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, and 3) record reductions in interfund loans for amounts that are not expected to be repaid. During the year ended September 30, 2004, the State made a one-time transfer from the Compact Capital Projects Fund to the Compact Trust Fund of \$4,900,000 representing the State's contribution to the Trust Fund established in accordance with the Compact of Free Association.

(7) Long-term Obligations

Primary Government

Asian Development Bank (ADB) Early Retirement Program Loan

During the year ended September 30, 1998, the State implemented an Early Retirement Scheme (ERS) in which employees holding certain nonessential positions as identified by the State were retired early with a payout of the equivalent of two-years' wages. This ERS program is funded by a \$3,500,000 loan from the ADB through the FSM National Government. The activities of the ERS Program are recorded in the General Fund.

The ADB loan has a grace period of ten years with the first payment due in February 2008 and the last payment in August 2038. However, pursuant to the terms of the Financing Agreement between the State and the FSM National Government, the State is required to deposit into the ERS Trust account held in the name of the State within the FSM National Government investment portfolio, 100% of the outstanding principal balance by September 30, 2002.

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year ending September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ -	\$ -	\$ -
2006	-	-	-
2007	-	-	-
2008	116,667	-	116,667
2009	116,667	-	116,667
2010 – 2014	583,335	-	583,335
2015 – 2019	583,335	-	583,335
2020 – 2024	583,335	-	583,335
2025 – 2029	583,335	-	583,335
2030 – 2034	583,335	-	583,335
2035 – 2038	349,991	-	349,991
	<u>\$ 3,500,000</u>	<u>\$ -</u>	<u>\$ 3,500,000</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(7) Long-term Obligations, Continued

Primary Government, Continued

Asian Development Bank (ADB) Early Retirement Program Loan, Continued

Funds for the repayment of the ADB loan are expected to be derived from the annual appropriations for salaries and wages earmarked for the positions abolished under the Early Retirement Scheme. The Financing Agreement requires the State to continue to appropriate salaries for the abolished positions and deposit the appropriate funds into the ERS Trust Account. \$3,500,000 identified for future debt service payments is included in the General Fund reserve for related assets of which \$2,297,587 is actually deposited in an investment account held jointly with the FSM National Government. That investment account is restricted for the repayment of this debt.

Land Acquisition Claims Payable

As of September 30, 2004, \$249,607 in long-term payments due under land purchase agreements were identified by the State. This total comprises indefinite land use payments and other lease payments for which payment dates cannot be determined due to heirship disputes.

Other long-term liabilities will be liquidated in the future from governmental funds. During the year ended September 30, 2004, the following changes occurred in liabilities reported as part of the primary government's long-term liabilities in the statement of net assets:

	Balance October 1, 2003	<u>Additions</u>	<u>Reductions</u>	Balance September 30, 2004	Due Within <u>One Year</u>
Loan payable:					
ADB loan	\$ 3,500,000	\$ -	\$ -	\$ 3,500,000	\$ -
Other:					
Compensated absences	527,445	85,655	(101,086)	512,014	85,655
Land acquisition claims	237,583	12,024	-	249,607	-
	<u>765,028</u>	<u>97,679</u>	<u>(101,086)</u>	<u>761,621</u>	<u>85,655</u>
	<u>\$ 4,265,028</u>	<u>\$ 97,679</u>	<u>\$ (101,086)</u>	<u>\$ 4,261,621</u>	<u>\$ 85,655</u>

Discretely Presented Component Units

Yap State Public Service Corporation (YSPSC)

Loan payable to the FSM National Government for construction of certain water projects. This loan is uncollateralized and is a subsidiary loan to a loan agreement between the Asian Development Bank (ADB) and the FSM National Government, with interest at 6.82% on the outstanding balance; however, the FSM National Government has waived the interest payment requirement. The loan is repayable in Special Drawing Rights commencing August 2007 with the final payment due in August 2036.

\$ 2,270,837

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(7) Long-term Obligations, Continued

Discretely Presented Component Units, Continued

Yap State Public Service Corporation (YSPSC), Continued

Uncollateralized note payable to the State in quarterly interest only payments through March 2003; monthly principal and interest payments of \$5,651 starting June 1, 2003; interest at 2%, maturing in May 2017. 758,209

Note payable to United States of America, acting through the Rural Housing Service, for the construction of the warehouse facility and main office. The note is payable in monthly installments of \$1,075 including interest at 4.625% commencing March 26, 2003 and maturing in September 2013. The note is collateralized by YSPSC's equipment, furniture and fixtures located at YSPSC's office. 89,661

3,118,707

The Diving Seagull, Inc.

Loan payable to the FSM Development Bank to cover the dry-dock costs of a fishing vessel. The loan is payable in quarterly installments of \$44,100, including interest at 9% per annum, commencing June 25, 2003. The loan is collateralized by chattel mortgage on all property and equipment of DSI, including the fishing vessel MV Mathawmarfach. 966,357

\$ 4,085,064

Annual debt service requirements to maturity for principal and interest are as follows:

<u>Year ending</u> <u>September 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 154,564	\$ 18,638	\$ 173,202
2006	164,669	17,143	181,812
2007	198,324	15,606	213,930
2008	232,898	14,028	246,926
2009	245,766	12,404	258,170
2010 - 2014	982,680	36,736	1,019,416
2015 - 2019	592,302	4,881	597,183
2020 - 2024	605,630	-	605,630
2025 - 2029	605,630	-	605,630
2030 - 2034	<u>302,601</u>	<u>-</u>	<u>302,601</u>
	<u>\$ 4,085,064</u>	<u>\$ 119,436</u>	<u>\$ 4,204,500</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(8) Continuing Appropriations

Continuing appropriations as of September 30, 2004, are as follows:

Major Governmental Funds

General Fund:

Autopsies (YSL No. 5-47)	\$ 18,191
Can recycling (YSL No. 5-46 and 5-85)	14,679
FEMA matching (YSL No. 5-84)	227,311
Disaster/Search and Rescue (YSL No. 5-84)	5,380
Court building project (YSL No. 6-5)	2,798
20% revenue sharing (YSL No. 6-5)	612,138
Yap Constitutional Convention (YSL No. 6-27)	28,169
Typhoon Mitag Matching (YSL No. 6-23)	229,309
Typhoon Sudal Recovery Work (YSL No. 6-30)	220,710
Typhoon Lupit Matching (YSL No. 6-31)	324,709
Historic Preservation Office Cultural Museum Design (YSL No. 6-31)	92,130
Replacement vessel (YSL No. 6-31)	<u>50,000</u>
	\$ <u>1,825,524</u>

Compact Capital Projects Fund:

Yap State Loan (YSL No. 5-1)	200,000
Yap Airport Project (YSL No. 5-23)	372,090
Road Phase VII (YSL No. 5-23)	25,783
Outer Island Airfield Projects (YSL No. 5-23)	21,888
KGAI New Tower (YSL No. 5-42)	309
Gargey Road/Water Project (YSL No. 5-59)	25,606
Southern Road Project (YSL No. 6-5)	67,039
Public Schools Facilities Recovery (YSL No. 6-34)	<u>1,500,000</u>
	\$ <u>2,212,715</u>

Nonmajor Governmental Funds

Yap Community Development Program matching (YSL No. 5-34)	\$ <u>150,000</u>
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(9) Contingencies

Sick Leave

It is the policy of the State to record expenditures for sick leave when leave is actually taken. Sick leave is compensated time for absence during working hours arising from employee illness or injury. The estimated accumulated amount of unused sick leave as of September 30, 2004 is currently not determinable.

Insurance Coverage

The State does not maintain insurance coverage for a significant amount of fixed assets. In the event of a catastrophe, the State may be self-insured to a material extent.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Financial Statements
September 30, 2004

(9) Contingencies, Continued

Federal Grants

The State participates in a number of federally assisted grant programs. These programs are subject to financial and compliance audits to ascertain if Federal laws and guidelines have been followed. Cumulative questioned costs of \$378,679 relating to fiscal years 1999 through 2004 have been set forth in the State's Single Audit Report for the year ended September 30, 2004. The ultimate disposition of these questioned costs can be determined only by final action of the respective grantor agencies. Therefore, no provision for any liability that may result upon resolution of this matter has been made in the accompanying financial statements.

Litigation

The State is party to several legal proceedings arising from governmental operations. Claims are filed with the State's Attorney General. Approved claims are usually paid under general appropriations to the affected government agency. At September 30, 2004, there existed several unapproved claims. The State's Attorney General is of the opinion that the State Liability Act has established claims limits of \$40,000 for wrongful injuries and \$20,000 for deaths. Current claims against the State exist but do not appear to be material. Management has not provided for such claims in the accompanying financial statements as it is not currently possible to estimate the State's potential liability, if any, arising from these claims.

Indefinite Land Use Sites

Payment obligations on rental lands termed "Indefinite Land Use Sites" were originally undertaken by the Trust Territory of the Pacific Islands (TTPI), for which obligation on these lands ceased in May, 1984. Subsequent to May 1984, responsibility to rent or purchase the sites was transferred to the State. The State's Division of Land and Surveys has estimated that the State may be responsible for funding the indefinite land use sites for back rent with interest. The State is actively attempting to negotiate purchase prices for these properties.

(10) Individual Deficit Fund Balances

Specific individual funds which had significant individual deficit fund balances as at September 30, 2004, are as follows:

Nonmajor Governmental Funds

Sports Development Fund	\$ <u>63,318</u>
CFSM Capital Projects Fund	\$ <u>10,483</u>

STATE OF YAP
FEDERATED STATES OF MICRONESIA

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2004

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Schedule of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund
Year Ended September 30, 2004

	Budgeted Amounts		Actual - Budgetary	Variance with Final Budget
	Original	Final	Basis (see Note 1)	
Revenues:				
Revenue sharing	2,732,734	2,732,734	2,433,187	(299,547)
Excise taxes	757,216	757,216	1,212,463	455,247
Fees and charges	-	-	377,620	377,620
Departmental charges	361,343	361,343	323,133	(38,210)
Net increase in the fair value of investments	2,871,498	2,871,498	3,118,031	246,533
Other	-	-	572,598	572,598
Total revenues	<u>6,722,791</u>	<u>6,722,791</u>	<u>8,037,032</u>	<u>1,314,241</u>
Expenditures:				
Current:				
General government	1,399,347	1,399,347	2,153,285	(753,938)
Health services	208,806	208,806	603,481	(394,675)
Education	-	-	55,683	(55,683)
Economic development	-	-	142,726	(142,726)
Public safety	87,319	87,319	170,592	(83,273)
Public works and transportation	1,562,176	1,562,176	1,682,213	(120,037)
Community affairs	493,971	493,971	271,060	222,911
Boards and commissions	398,050	398,050	291,517	106,533
Payments to component units	468,822	468,822	469,710	(888)
Other	1,874,991	1,874,991	224,041	1,650,950
Total expenditures	<u>6,493,482</u>	<u>6,493,482</u>	<u>6,064,308</u>	<u>429,174</u>
Excess of revenues over expenditures	<u>229,309</u>	<u>229,309</u>	<u>1,972,724</u>	<u>1,743,415</u>
Other financing uses:				
Operating transfers out	<u>(229,309)</u>	<u>(229,309)</u>	<u>(597,273)</u>	<u>(367,964)</u>
Net change in unreserved fund balance	-	-	1,375,451	1,375,451
Other changes in unreserved fund balance:				
Increase in reserve for related assets	-	-	(618,834)	(618,834)
Increase in reserve for continuing appropriations	-	-	(187,265)	(187,265)
Unreserved fund balance at the beginning of the year	<u>19,616,944</u>	<u>19,616,944</u>	<u>19,616,944</u>	-
Unreserved fund balance at the end of the year	<u>\$ 19,616,944</u>	<u>\$ 19,616,944</u>	<u>\$ 20,186,296</u>	<u>\$ 569,352</u>

See accompanying notes to required supplementary information - budgetary reporting.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Notes to Required Supplementary Information - Budgetary Reporting
September 30, 2004

(1) Budgetary Information

An annual appropriated budget is adopted by the State's Legislature for the General Fund and Compact Programs through an Appropriations Act. However, additional appropriations and budget modifications occur throughout the year. The majority of unencumbered appropriations lapse as of year end unless specifically extended by the State's Legislature. Budgets for special revenue funds, except the Compact Program Fund, are not included in the annual Appropriations Act. Accordingly, a budget to actual presentation for special revenue funds, except the Compact Program Fund, is not required or presented. Project-length financial plans are generally adopted for all capital project funds.

Encumbrance accounting is utilized for budgetary control purposes. Encumbrances outstanding at year-end are reported as reservations of fund balance and will be funded as expenditures in the ensuing year. Encumbrances remain as reservations of fund balance until becoming expended or canceled. If an encumbrance is subsequently canceled, the funds revert to the applicable unreserved fund balance unless otherwise required by law.

Budgetary expenditures, which are on a basis other than GAAP, represent current charges against appropriations; current charges consist of all current year liquidated and unliquidated encumbrances. Budgetary expenditures are therefore determined by subtracting both current year liquidations of prior year encumbrances and unliquidated prior year encumbrances from the combined total of current year. When reviewed in relation to respective budgets, budgetary expenditures provide the principal means of evaluating current year operating performance and management stewardship. Amounts included on the Statement of Revenues, Expenditures, and Changes in Fund Balance - Budget and Actual - General Fund (which are presented on a non-GAAP budgetary basis) are reconciled to unreserved fund balance of the Combined Balance Sheet within the other charges in unreserved fund balance section of that statement.

Encumbrance accounting is employed in governmental funds. For budgetary purposes, the encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year end are reported as reservations of fund balances and do not constitute expenditures or liabilities because the commitments will be reappropriated and honored during the subsequent fiscal year.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

OTHER SUPPLEMENTARY INFORMATION

YEAR ENDED SEPTEMBER 30, 2004

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combining Schedule of Expenditures by Account
Governmental Funds
Year Ended September 30, 2004

	Special Revenue		Capital Projects	Permanent		Other Governmental Funds	Total
	General	U.S Federal Grants	Compact Sector Grants	Compact Capital Projects	Compact Trust		
Expenditures:							
Salaries and wages	\$ 1,325,609	\$ 949,707	\$ 3,756,099	\$ 10,909	\$ -	\$ 223,416	\$ 6,265,740
Grants and subsidies	674,752	-	202,286	-	-	468,460	1,345,498
Contractual services	648,183	392,997	147,902	582,830	-	676,152	2,448,064
Capital outlay	974,375	32,666	137,917	-	-	44,666	1,189,624
Supplies and materials	121,766	43,670	764,694	-	-	15,577	945,707
Utilities	727,237	-	863	-	-	-	728,100
Travel	228,467	365,087	263,361	-	-	19,156	876,071
Medical supplies	177,107	9,946	391,929	-	-	-	578,982
Medical referral	313,585	-	48,923	-	-	-	362,508
Scholarship and training	26,750	34,130	139,000	-	-	17,435	217,315
POL	216,497	11,594	52,803	-	-	156,343	437,237
Communications	86,489	76,592	101,848	-	-	6,917	271,846
Food stuffs	107,790	116,165	27,413	-	-	5,302	256,670
Rentals	6,819	6,861	8,164	-	-	77,285	99,129
Allowances	99,810	600	-	-	-	-	100,410
Repairs and maintenance	18,675	10,368	27,615	-	-	90,911	147,569
Professional services	27,178	52,360	287,187	-	-	-	366,725
Printing and reproduction	53,348	2,804	33,570	-	-	3,055	92,777
Freight	50,742	1,686	59,281	-	-	13,302	125,011
Leased housing	3,918	12,885	100,743	74,365	-	-	191,911
Other	277,506	30,667	169,894	-	-	287,552	765,619
	<u>\$ 6,166,603</u>	<u>\$ 2,150,785</u>	<u>\$ 6,721,492</u>	<u>\$ 668,104</u>	<u>\$ -</u>	<u>\$ 2,105,529</u>	<u>\$ 17,812,513</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

GENERAL FUND

September 30, 2004

The general fund is used to account for resources traditionally associated with government which are not required legally or by sound financial management to be accounted for in another fund. The United States Compact of Free Association current account and inflation adjustment funds associated with the current account are accounted for in this fund in addition to local taxes and other revenues.

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance - General Fund
Year Ended September 30, 2004
(with comparative totals for the year ended September 30, 2003)

	<u>2004</u>	<u>2003</u>
Revenues:		
Compact funds:		
Current Section 211(a) base grant	\$ -	\$ 4,836,027
Current Section 217 inflation adjustment	-	2,804,895
	<u>-</u>	<u>7,640,922</u>
Revenue sharing:		
Import tax	768,871	-
Fuel tax	34,110	-
Income tax	974,041	-
Business gross receipts tax	723,497	-
Unallocated	(67,332)	1,382,787
	<u>2,433,187</u>	<u>1,382,787</u>
Excise taxes:		
Alcoholic beverages	478,474	549,826
Gasoline and diesel	67,586	60,510
Tobacco	159,130	150,728
Other excise taxes	507,273	464,543
	<u>1,212,463</u>	<u>1,225,607</u>
Fees and charges:		
Licenses and permits	80,550	79,264
Fines/sale of confiscated property	81,044	111,036
Leases and other rentals	216,026	392,198
	<u>377,620</u>	<u>582,498</u>
Departmental charges:		
Sea transportation	131,320	160,009
Hospital services	157,145	140,234
Other	34,668	132,133
	<u>323,133</u>	<u>432,376</u>
Interest and dividends	-	-
Net increase in the fair value of investments	3,118,031	5,878,201
Other revenues	572,598	609,688
Total revenues	<u>8,037,032</u>	<u>17,752,079</u>
Expenditures:		
Current:		
General government:		
Office of the Governor	211,637	226,865
State Legislature	410,858	407,412
Office of Administrative Services	761,107	741,167
Office of Planning, Budget and Statistics	92,586	151,533
Division of Revenue and Taxation	-	91,116
Disaster relief programs	630,025	154,055
Other	-	11,780
	<u>2,106,213</u>	<u>1,783,928</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures by Function,
and Changes in Fund Balance - General Fund, Continued
Year Ended September 30, 2004
(with comparative totals for the year ended September 30, 2003)

	2004	2003
Expenditures, continued:		
Current, continued:		
Health services:		
Department of Health Services	650,280	1,735,632
Education:		
Department of Education	138,642	764,165
Economic Development:		
Department of Resources and Development	132,038	567,402
Public Safety:		
Department of Public Safety/Attorney General	244,602	622,896
Public Works and Transportation:		
Department of Public Works and Transportation	1,662,243	1,837,998
Community Affairs		
Department of Public Affairs	257,399	322,992
Boards and Commissions:		
Council of Pilung	99,772	100,272
Council of Tamol	104,722	127,520
Small Business Development Center	5,069	-
Farmers Home Administration	18,302	-
Historic Preservation Office	28,193	-
Yap Public Library	20,736	-
EPA Administration Board	-	77,884
	276,794	305,676
Payments to component units:		
Public Transportation System	133,038	109,220
Yap Visitor's Bureau	255,672	574,250
Southern Yap Water System	-	-
Yap Fishing Authority	81,000	-
	469,710	683,470
Other:		
Judiciary	-	166,823
Public Auditor	1,398	60,806
Micronesia Legal Services Corporation	41,280	-
Japan Overseas Cooperation Volunteers	9,430	-
Peace Corps Program	14,675	-
Yap Community Action Program	129,526	-
Other	32,373	7,416,399
	228,682	7,644,028
Total expenditures	6,166,603	16,268,187
Excess of revenues over expenditures	1,870,429	1,483,892
Other financing uses:		
Operating transfers out	(597,273)	(2,528,211)
Net change in fund balance	1,273,156	(1,044,319)
Fund balance at the beginning of the year	29,457,010	30,501,329
Fund balance at the end of the year	\$ 30,730,166	\$ 29,457,010

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund
Year Ended September 30, 2004

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Revenues:				
Revenue sharing:				
Import tax	\$ -	\$ -	\$ 768,871	\$ 768,871
Fuel tax	-	-	34,110	34,110
Income tax	-	-	974,041	974,041
Business gross receipts tax	-	-	723,497	723,497
Unallocated	2,732,734	2,732,734	(67,332)	(2,800,066)
	<u>2,732,734</u>	<u>2,732,734</u>	<u>2,433,187</u>	<u>(299,547)</u>
Excise taxes:				
Alcoholic beverages	-	-	478,474	478,474
Gasoline and diesel	-	-	67,586	67,586
Tobacco	-	-	159,130	159,130
Other excise taxes	757,216	757,216	507,273	(249,943)
	<u>757,216</u>	<u>757,216</u>	<u>1,212,463</u>	<u>455,247</u>
Fees and charges:				
Licenses and permits	-	-	80,550	80,550
Fines/sale of confiscated property	-	-	81,044	81,044
Leases and other rentals	-	-	216,026	216,026
	<u>-</u>	<u>-</u>	<u>377,620</u>	<u>377,620</u>
Departmental charges:				
Sea transportation	135,000	135,000	131,320	(3,680)
Hospital services	190,343	190,343	157,145	(33,198)
Other	36,000	36,000	34,668	(1,332)
	<u>361,343</u>	<u>361,343</u>	<u>323,133</u>	<u>(38,210)</u>
Net increase in the fair value of investments	2,871,498	2,871,498	3,118,031	246,533
Other revenues	-	-	572,598	572,598
Total revenues	<u>6,722,791</u>	<u>6,722,791</u>	<u>8,037,032</u>	<u>1,314,241</u>
Expenditures:				
Current:				
General government:				
Office of the Governor	174,524	174,524	219,230	(44,706)
State Legislature	480,260	480,260	394,304	85,956
Office of Administrative Services	2,000	2,000	735,403	(733,403)
Office of Planning and Statistics	-	-	25,988	(25,988)
Disaster relief programs	742,563	742,563	778,360	(35,797)
	<u>1,399,347</u>	<u>1,399,347</u>	<u>2,153,285</u>	<u>(753,938)</u>
Health services:				
Department of Health Services	208,806	208,806	603,481	(394,675)
Education:				
Department of Education	-	-	55,683	(55,683)

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual - General Fund, Continued
Year Ended September 30, 2004

	Budgeted Amounts		Actual Amounts	Variance
	Original	Final		
Expenditures, continued:				
Current, continued:				
Economic Development:				
Department of Resources and Development	-	-	142,726	(142,726)
Public Safety:				
Department of Public Safety/Attorney General	87,319	87,319	170,592	(83,273)
Public Works and Transportation:				
Department of Public Works and Transportation	1,562,176	1,562,176	1,682,213	(120,037)
Community Affairs				
Department of Public Affairs	493,971	493,971	271,060	222,911
Boards and Commissions:				
Council of Pilung	110,786	110,786	111,079	(293)
Council of Tamol	151,037	151,037	138,454	12,583
Small Business Development Center	-	-	1,900	(1,900)
Farmers Home Administration	20,413	20,413	18,386	2,027
Historic Preservation Office	88,317	88,317	2,906	85,411
Yap Public Library	27,497	27,497	20,736	6,761
EPA Administration Board	-	-	(1,944)	1,944
	398,050	398,050	291,517	106,533
Payments to component units:				
Public Transportation System	133,038	133,038	133,038	-
Yap Visitor's Bureau	254,784	254,784	255,672	(888)
Yap Fishing Authority	81,000	81,000	81,000	-
	468,822	468,822	469,710	(888)
Other:				
Judiciary	-	-	(3,882)	3,882
Public Auditor	18,560	18,560	(37)	18,597
Micronesian Legal Services Corporation	41,280	41,280	41,280	-
Japan Overseas Cooperation Volunteers	17,563	17,563	9,375	8,188
Peace Corps Program	24,493	24,493	14,675	9,818
Yap Community Action Program	131,190	131,190	129,526	1,664
Emergency public facilities	1,500,000	1,500,000	-	1,500,000
Other	141,905	141,905	33,104	108,801
	1,874,991	1,874,991	224,041	1,650,950
Total expenditures	6,493,482	6,493,482	6,064,308	627,583
Excess of revenues over expenditures	229,309	229,309	1,972,724	686,658
Other financing uses:				
Operating transfers out	(229,309)	(229,309)	(597,273)	(367,964)
Net change in fund balance	-	-	1,375,451	1,375,451
Other changes in unreserved fund balance:				
Increase in reserve for related assets	-	-	(618,834)	(618,834)
Increase in reserve for continuing appropriations	-	-	(187,265)	(187,265)
Unreserved fund balance at the beginning of the year	19,616,944	19,616,944	19,616,944	-
Unreserved fund balance at the end of the year	\$ 19,616,944	\$ 19,616,944	\$ 20,186,296	\$ 569,352

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Balance Sheet
Nonmajor Governmental Funds
September 30, 2004

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
<u>ASSETS</u>			
Cash and cash equivalents	\$ 155,191	\$ -	\$ 155,191
Equity interest in internal investment pool	1,832,807	-	1,832,807
Receivables, net:			
CFSM	33,793	-	33,793
Other	24,502	-	24,502
Due from other funds	<u>1,006,615</u>	<u>267,489</u>	<u>1,274,104</u>
Total assets	<u>\$ 3,052,908</u>	<u>\$ 267,489</u>	<u>\$ 3,320,397</u>
 <u>LIABILITIES AND FUND BALANCES</u>			
Liabilities:			
Accounts payable	\$ 300,324	\$ 61,672	\$ 361,996
Other liabilities and accruals	19,217	-	19,217
Deferred revenue	640,020	-	640,020
Due to other funds	<u>24,171</u>	<u>-</u>	<u>24,171</u>
Total liabilities	<u>983,732</u>	<u>61,672</u>	<u>1,045,404</u>
Fund balances:			
Reserved for:			
Encumbrances	560,277	316,484	876,761
Continuing appropriations	150,000	-	150,000
Unreserved:			
Special revenue funds	1,358,899	-	1,358,899
Capital projects funds	<u>-</u>	<u>(110,667)</u>	<u>(110,667)</u>
Total fund balances	<u>2,069,176</u>	<u>205,817</u>	<u>2,274,993</u>
Total liabilities and fund balances	<u>\$ 3,052,908</u>	<u>\$ 267,489</u>	<u>\$ 3,320,397</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2004

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Federal contributions and other grants	\$ 1,182,532	\$ -	\$ 1,182,532
CFSM grants	139,482	83,117	222,599
Excise taxes	133,560	-	133,560
Fees and charges	10,772	-	10,772
Total revenues	<u>1,466,346</u>	<u>83,117</u>	<u>1,549,463</u>
Expenditures by function:			
Current:			
General government	1,273,200	-	1,273,200
Health services	1,474	-	1,474
Education	44,333	-	44,333
Economic development	27,181	-	27,181
Public safety	19,466	-	19,466
Public works and transportation	47,307	447,070	494,377
Judiciary	41,265	-	41,265
Other	157,680	-	157,680
Capital projects	-	46,553	46,553
Total expenditures	<u>1,611,906</u>	<u>493,623</u>	<u>2,105,529</u>
Deficiency of revenues under expenditures	<u>(145,560)</u>	<u>(410,506)</u>	<u>(556,066)</u>
Other financing sources:			
Operating transfers in	<u>181,805</u>	<u>415,468</u>	<u>597,273</u>
Net change in fund balances	36,245	4,962	41,207
Fund balances at the beginning of the year	<u>2,032,931</u>	<u>200,855</u>	<u>2,233,786</u>
Fund balances at the end of the year	<u>\$ 2,069,176</u>	<u>\$ 205,817</u>	<u>\$ 2,274,993</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Combined Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances
Nonmajor Governmental Funds
Year Ended September 30, 2004

	<u>Other Special Revenue</u>	<u>Other Capital Projects</u>	<u>Total</u>
Revenues:			
Federal contributions and other grants	\$ 1,182,532	\$ -	\$ 1,182,532
CFSM grants	139,482	83,117	222,599
Excise taxes	133,560	-	133,560
Fees and charges	10,772	-	10,772
Total revenues	<u>1,466,346</u>	<u>83,117</u>	<u>1,549,463</u>
Expenditures by account:			
Salaries and wages	205,735	17,681	223,416
Grants and subsidies	468,460	-	468,460
Contractual services	201,763	474,389	676,152
Supplies and materials	15,577	-	15,577
Scholarship and training	17,435	-	17,435
Travel	19,156	-	19,156
Capital outlay	44,666	-	44,666
Rentals	77,285	-	77,285
Food stuffs	5,302	-	5,302
Communications	6,917	-	6,917
Printing and reproduction	3,055	-	3,055
Repairs and maintenance	90,911	-	90,911
Freight	11,749	1,553	13,302
POL	156,343	-	156,343
Other	287,552	-	287,552
Total expenditures	<u>1,611,906</u>	<u>493,623</u>	<u>2,105,529</u>
Deficiency of revenues under expenditures	<u>(145,560)</u>	<u>(410,506)</u>	<u>(556,066)</u>
Other financing sources:			
Operating transfers in	<u>181,805</u>	<u>415,468</u>	<u>597,273</u>
Net change in fund balances	36,245	4,962	41,207
Fund balances at the beginning of the year	<u>2,032,931</u>	<u>200,855</u>	<u>2,233,786</u>
Fund balances at the end of the year	<u>\$ 2,069,176</u>	<u>\$ 205,817</u>	<u>\$ 2,274,993</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - SPECIAL REVENUE FUNDS

September 30, 2004

Special revenue funds are used to account for specific revenues that are legally restricted for particular purposes. A brief discussion of the State's Nonmajor Governmental Funds - Special Revenue Funds as of September 30, 2004, follows:

Section 221(b) Special Block Grant Fund

This fund is used to account for financial transactions related to the Compact program accounts under Section 221(b) of the Compact of Free Association.

Other U.S. Grants Fund

This fund is used to account for all Federal Emergency Management Agency (FEMA) grants received directly or in a subrecipient capacity through the FSM National Government.

Non-U.S. Grants Fund

This fund is used to account for all financial transactions related to certain direct and other grants received from various world organizations.

CFSM Grants Fund

This fund is used to account for appropriations made to the State from the Congress of the Federated States of Micronesia (CFSM). These grants are earned on a reimbursable basis.

Sports Development Fund

This fund accounts for certain funds dedicated to sports development in the State.

General Services Agency Fund

This fund accounts for funds dedicated to the acquisition of certain supplies for the State.

Other Special Revenue Funds

This fund accounts for funds dedicated to certain special purposes.

See Accompanying Independent Auditors' Report.

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Balance Sheet
 September 30, 2004

	Section 221(b) Special Block Grant	Other U.S. Grants	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Total
ASSETS								
Cash and cash equivalents	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 155,191	\$ 155,191
Equity interest in internal investment pool	1,832,807	-	-	-	-	-	-	1,832,807
Receivables, net:								
CFSM	-	-	-	33,793	-	-	-	33,793
Other	-	-	18	20,000	-	4,484	-	24,502
Due from other funds	-	848,839	64,950	12,478	-	56,451	23,897	1,006,615
Total assets	\$ 1,832,807	\$ 848,839	\$ 64,968	\$ 66,271	\$ -	\$ 60,935	\$ 179,088	\$ 3,052,908
LIABILITIES AND FUND BALANCES (DEFICITS)								
Liabilities:								
Accounts payable	\$ 37,559	\$ 184,573	\$ -	\$ 34,281	\$ 39,147	\$ 2,341	\$ 2,423	\$ 300,324
Other liabilities and accruals	12,636	315	-	1,812	-	4,454	-	19,217
Deferred revenue	-	640,020	-	-	-	-	-	640,020
Due to other funds	-	-	-	-	24,171	-	-	24,171
Total liabilities	50,195	824,908	-	36,093	63,318	6,795	2,423	983,732
Fund balances (deficits):								
Reserved for:								
Encumbrances	50,074	372,481	21,970	114,672	-	-	1,080	560,277
Continuing appropriations	150,000	-	-	-	-	-	-	150,000
Unreserved (deficit)	1,582,538	(348,550)	42,998	(84,494)	(63,318)	54,140	175,585	1,358,899
Total fund balances (deficits)	1,782,612	23,931	64,968	30,178	(63,318)	54,140	176,665	2,069,176
Total liabilities and fund balances (deficits)	\$ 1,832,807	\$ 848,839	\$ 64,968	\$ 66,271	\$ -	\$ 60,935	\$ 179,088	\$ 3,052,908

See Accompanying Independent Auditors' Report.

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Function,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2004

	Section 221(b) Special Block Grant	Other U.S. Grants	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Total
Revenues:								
Federal contributions and other grants	\$ -	\$ 1,083,132	\$ 99,400	\$ -	\$ -	\$ -	\$ -	\$ 1,182,532
CFSM grants	-	-	-	139,482	-	-	-	139,482
Excise taxes	-	-	-	-	133,560	-	-	133,560
Fees and charges	-	-	-	-	-	-	10,772	10,772
Total revenues	-	1,083,132	99,400	139,482	133,560	-	10,772	1,466,346
Expenditures by function:								
Current:								
General government	1,903	1,240,996	-	20,967	-	9,334	-	1,273,200
Health services	-	-	165	1,309	-	-	-	1,474
Education	39,311	-	-	-	-	-	5,022	44,333
Economic development	-	-	19,209	7,972	-	-	-	27,181
Public safety	-	-	-	19,466	-	-	-	19,466
Public works and transportation	-	-	-	47,307	-	-	-	47,307
Judiciary	-	-	-	41,265	-	-	-	41,265
Other	-	-	-	1,196	-	-	3,074	157,680
Total expenditures	41,214	1,240,996	19,374	139,482	153,410	9,334	8,096	1,611,906
Excess (deficiency) of revenues over (under) expenditures	(41,214)	(157,864)	80,026	-	(19,850)	(9,334)	2,676	(145,560)
Other financing sources:								
Operating transfers in	-	181,805	-	-	-	-	-	181,805
Net change in fund balances (deficit)	(41,214)	23,941	80,026	-	(19,850)	(9,334)	2,676	36,245
Fund balances (deficits) at the beginning of the year	1,823,826	(10)	(15,058)	30,178	(43,468)	63,474	173,989	2,032,931
Fund balances (deficits) at the end of the year	1,782,612	23,931	64,968	30,178	(63,318)	54,140	176,665	2,069,176

See Accompanying Independent Auditors' Report.

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 SPECIAL REVENUE FUNDS

Combining Statement of Revenues, Expenditures By Account,
 and Changes in Fund Balances (Deficits)
 Year Ended September 30, 2004

	Section 221(b) Special Block Grant	Other U.S. Grants	Non-U.S. Grants	CFSM Grants	Sports Development	General Services Agency	Other Special Revenue	Total
Revenues:								
Federal contributions and other grants	\$ -	\$ 1,083,132	\$ 99,400	\$ -	\$ -	\$ -	\$ -	\$ 1,182,532
CFSM grants	-	-	-	139,482	-	-	-	139,482
Excise taxes	-	-	-	-	133,560	-	-	133,560
Fees and charges	-	-	-	-	-	-	10,772	10,772
Total revenues	-	1,083,132	99,400	139,482	133,560	-	10,772	1,466,346
Expenditures by account:								
Salaries and wages	-	182,431	3,416	19,888	-	-	-	205,735
Grants and subsidies	-	315,050	-	-	153,410	-	-	468,460
Contractual services	-	137,439	7,731	56,593	-	-	-	201,763
Supplies and materials	-	6,306	1,264	8,007	-	-	-	15,577
Scholarship and training	-	-	-	17,435	-	-	-	17,435
Travel	-	6,252	631	10,069	-	-	2,204	19,156
Capital outlay	-	36,919	3,039	4,483	-	-	225	44,666
Rentals	-	75,476	508	176	-	-	1,125	77,285
Food stuffs	-	726	679	-	-	-	3,897	5,302
Communications	-	3,217	-	3,700	-	-	-	6,917
Printing and reproduction	-	285	540	2,230	-	-	-	3,055
Repairs and maintenance	-	88,175	1,079	1,012	-	-	645	90,911
Freight	-	11,512	-	237	-	-	-	11,749
POL	-	149,178	-	7,165	-	-	-	156,343
Other	41,214	228,030	487	8,487	-	9,334	-	287,552
Total expenditures	41,214	1,240,996	19,374	139,482	153,410	9,334	8,096	1,611,906
Excess (deficiency) of revenues over (under) expenditures	(41,214)	(157,864)	80,026	-	(19,850)	(9,334)	2,676	(145,560)
Other financing sources:								
Operating transfers in	-	181,805	-	-	-	-	-	181,805
Net change in fund balances (deficit)	(41,214)	23,941	80,026	-	(19,850)	(9,334)	2,676	36,245
Fund balances (deficits) at the beginning of the year	1,823,826	(10)	(15,058)	30,178	(43,468)	63,474	173,989	2,032,931
Fund balances (deficits) at the end of the year	\$ 1,782,612	\$ 23,931	\$ 64,968	\$ 30,178	\$ (63,318)	\$ 54,140	\$ 176,665	\$ 2,069,176

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS - CAPITAL PROJECTS FUNDS

September 30, 2004

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds and trust funds. A brief discussion of the State's Nonmajor Governmental Funds - Capital Projects Funds as of September 30, 2004, follows:

Public Infrastructure Development Fund

This fund accounts for United States Congress appropriations under United States Public Law 99-239, as amended, Title II, Article I, Section 211(d) and approved by the FSM Congress.

CFSM Capital Projects Fund

This fund is used to account for grants awarded by the Congress of the Federated States of Micronesia (CFSM) for improvement and betterment projects within the State.

Yap State Public Projects Fund

This fund is used to account for an appropriation from the FSM National Government which initially has been loaned to the Yap Fishing Corporation (through YEDA) and after repayment will be used to fund certain capital projects. Appropriations by the State's Legislature for capital improvement projects funded by the General Fund are also accounted for within this fund.

Water Development Projects Revolving Fund

This fund was established pursuant to YSL No. 4-69 to account for loan proceeds and other funds designated for State Water Development Projects.

See Accompanying Independent Auditors' Report.

STATE OF YAP
 FEDERATED STATES OF MICRONESIA
 NONMAJOR GOVERNMENTAL FUNDS
 CAPITAL PROJECTS FUNDS

Combining Balance Sheet
 September 30, 2004

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Total
<u>ASSETS</u>					
Due from other funds	\$ 425	\$ 50,764	\$ -	\$ 216,300	\$ 267,489
	<u>\$ 425</u>	<u>\$ 50,764</u>	<u>\$ -</u>	<u>\$ 216,300</u>	<u>\$ 267,489</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>					
Liabilities:					
Accounts payable	\$ 425	\$ 61,247	\$ -	\$ -	\$ 61,672
Total liabilities	<u>425</u>	<u>61,247</u>	<u>-</u>	<u>-</u>	<u>61,672</u>
Fund balances (deficits):					
Reserved for:					
Encumbrances	-	138,587	177,897	-	316,484
Unreserved	<u>-</u>	<u>(149,070)</u>	<u>(177,897)</u>	<u>216,300</u>	<u>(110,667)</u>
Total fund balances (deficits)	<u>-</u>	<u>(10,483)</u>	<u>-</u>	<u>216,300</u>	<u>205,817</u>
Total liabilities and fund balances	<u>\$ 425</u>	<u>\$ 50,764</u>	<u>\$ -</u>	<u>\$ 216,300</u>	<u>\$ 267,489</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2004

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Total
Revenues:					
CFSM grants	\$ -	\$ 83,117	\$ -	\$ -	\$ 83,117
	<u>-</u>	<u>83,117</u>	<u>-</u>	<u>-</u>	<u>83,117</u>
Expenditures by function:					
Current:					
Public works and transportation	-	36,564	410,506	-	447,070
Capital projects	-	46,553	-	-	46,553
Total expenditures	<u>-</u>	<u>83,117</u>	<u>410,506</u>	<u>-</u>	<u>493,623</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>-</u>	<u>(410,506)</u>	<u>-</u>	<u>(410,506)</u>
Other financing sources:					
Operating transfers in	-	-	415,468	-	415,468
Net change in fund balances (deficits)	<u>-</u>	<u>-</u>	<u>4,962</u>	<u>-</u>	<u>4,962</u>
Fund balances (deficits) at the beginning of the year	<u>-</u>	<u>(10,483)</u>	<u>(4,962)</u>	<u>216,300</u>	<u>200,855</u>
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ (10,483)</u>	<u>\$ -</u>	<u>\$ 216,300</u>	<u>\$ 205,817</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

NONMAJOR GOVERNMENTAL FUNDS
CAPITAL PROJECTS FUNDS

Combining Statement of Expenditures by Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2004

	Public Infrastructure Development	CFSM Capital Projects	Yap State Public Projects	Water Development Projects Revolving	Total
Revenues:					
CFSM grants	\$ -	\$ 83,117	\$ -	\$ -	\$ 83,117
	<u>-</u>	<u>83,117</u>	<u>-</u>	<u>-</u>	<u>83,117</u>
Expenditures by account:					
Contractual services	-	81,000	393,389	-	474,389
Salaries and wages	-	564	17,117	-	17,681
Freight	-	1,553	-	-	1,553
Total expenditures	<u>-</u>	<u>83,117</u>	<u>410,506</u>	<u>-</u>	<u>493,623</u>
Excess (deficiency) of revenues over (under) expenditures	<u>-</u>	<u>-</u>	<u>(410,506)</u>	<u>-</u>	<u>(410,506)</u>
Other financing sources:					
Operating transfers in	-	-	415,468	-	415,468
Net change in fund balances (deficits)	<u>-</u>	<u>-</u>	<u>4,962</u>	<u>-</u>	<u>4,962</u>
Fund balances (deficits) at the beginning of the year	<u>-</u>	<u>(10,483)</u>	<u>(4,962)</u>	<u>216,300</u>	<u>200,855</u>
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ (10,483)</u>	<u>\$ -</u>	<u>\$ 216,300</u>	<u>\$ 205,817</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Balance Sheet
September 30, 2004

	<u>Education Sector</u>	<u>Health Sector</u>	<u>Private Sector Development</u>	<u>Environment Sector</u>	<u>Capacity Building Sector</u>	<u>Total</u>
<u>ASSETS</u>						
Receivables:						
CFSM	\$ 54,804	\$ -	\$ -	\$ -	\$ 147,797	\$ 202,601
Due from other funds	-	193,043	188,577	35,765	-	417,385
	<u>\$ 54,804</u>	<u>\$ 193,043</u>	<u>\$ 188,577</u>	<u>\$ 35,765</u>	<u>\$ 147,797</u>	<u>\$ 619,986</u>
 <u>LIABILITIES AND FUND BALANCES (DEFICITS)</u>						
Liabilities:						
Accounts payable	\$ 20,326	\$ 93,805	\$ 4,339	\$ 8,067	\$ 43,527	\$ 170,064
Deferred revenue	-	99,238	183,754	27,698	-	310,690
Due to other funds	34,478	-	-	-	104,690	139,168
Total liabilities	<u>54,804</u>	<u>193,043</u>	<u>188,093</u>	<u>35,765</u>	<u>148,217</u>	<u>619,922</u>
Fund balances (deficits):						
Reserved for:						
Encumbrances	32,012	183,847	6,895	10,670	34,899	268,323
Unreserved	(32,012)	(183,847)	(6,411)	(10,670)	(35,319)	(268,259)
Total fund balances (deficits)	<u>-</u>	<u>-</u>	<u>484</u>	<u>-</u>	<u>(420)</u>	<u>64</u>
Total liabilities and fund balances	<u>\$ 54,804</u>	<u>\$ 193,043</u>	<u>\$ 188,577</u>	<u>\$ 35,765</u>	<u>\$ 147,797</u>	<u>\$ 619,986</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Statement of Revenues, Expenditures by Function,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2004

	Education Sector	Health Sector	Private Sector Development	Environment Sector	Capacity Building Sector	Total
Revenues:						
Compact funding	\$ 2,883,924	\$ 1,821,874	\$ 430,156	\$ 369,542	\$ 1,216,060	\$ 6,721,556
	<u>2,883,924</u>	<u>1,821,874</u>	<u>430,156</u>	<u>369,542</u>	<u>1,216,060</u>	<u>6,721,556</u>
Expenditures by function:						
Current:						
General government	-	-	-	-	459,243	459,243
Health services	-	1,811,876	-	-	-	1,811,876
Education	2,796,878	-	-	-	-	2,796,878
Economic development	87,046	9,998	165,821	41,387	65,503	369,755
Public safety	-	-	-	-	429,648	429,648
Public works and transportation	-	-	-	118,777	-	118,777
Boards and commissions	-	-	160,897	141,441	-	302,338
Payment to component units	-	-	102,954	-	-	102,954
Judiciary	-	-	-	-	168,402	168,402
Public auditor	-	-	-	-	93,684	93,684
Other	-	-	-	67,937	-	67,937
Total expenditures	<u>2,883,924</u>	<u>1,821,874</u>	<u>429,672</u>	<u>369,542</u>	<u>1,216,480</u>	<u>6,721,492</u>
Net change in fund balances (deficits)	-	-	484	-	(420)	64
Fund balances at the beginning of the year	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 484</u>	<u>\$ -</u>	<u>\$ (420)</u>	<u>\$ 64</u>

See Accompanying Independent Auditors' Report.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

COMPACT OF FREE ASSOCIATION
SECTION 211(a) SECTOR GRANT FUNDS

Combining Statement of Revenues, Expenditures by Account,
and Changes in Fund Balances (Deficits)
Year Ended September 30, 2004

	Education Sector	Health Sector	Private Sector Development	Environment Sector	Capacity Building Sector	Total
Revenues:						
Compact funding	\$ 2,883,924	\$ 1,821,874	\$ 430,156	\$ 369,542	\$ 1,216,060	\$ 6,721,556
	<u>2,883,924</u>	<u>1,821,874</u>	<u>430,156</u>	<u>369,542</u>	<u>1,216,060</u>	<u>6,721,556</u>
Expenditures by account:						
Salaries and wages	1,445,617	1,025,316	235,351	175,279	874,536	3,756,099
Grants and subsidies	31,395	-	102,954	67,937	-	202,286
Utilities	-	130	141	7	585	863
Medical referral	-	48,923	-	-	-	48,923
Contractual services	12,250	31,125	22,794	53,596	28,137	147,902
Supplies and materials	724,598	14,222	6,318	3,589	15,967	764,694
Scholarship and training	139,000	-	-	-	-	139,000
Travel	97,711	31,746	30,363	12,175	91,366	263,361
Capital outlay	1,759	103,712	2,879	-	29,567	137,917
Rentals	1,810	3,907	208	51	2,188	8,164
Food stuffs	3,942	5,013	289	529	17,640	27,413
Communications	20,157	22,938	8,736	9,923	40,094	101,848
Printing and reproduction	11,790	7,728	1,820	1,027	11,205	33,570
Repairs and maintenance	8,078	1,441	1,376	1,358	15,362	27,615
Leased housing	68,195	16,620	1,771	4,317	9,840	100,743
Freight	14,238	37,837	99	1,103	6,004	59,281
POL	14,570	3,007	1,867	6,493	26,866	52,803
Professional services	256,620	30,567	-	-	-	287,187
Medical supplies	-	391,929	-	-	-	391,929
Other	32,194	45,713	12,706	32,158	47,123	169,894
Total expenditures	<u>2,883,924</u>	<u>1,821,874</u>	<u>429,672</u>	<u>369,542</u>	<u>1,216,480</u>	<u>6,721,492</u>
Net change in fund balances (deficits)	-	-	484	-	(420)	64
Fund balances at the beginning of the year	-	-	-	-	-	-
Fund balances (deficits) at the end of the year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 484</u>	<u>\$ -</u>	<u>\$ (420)</u>	<u>\$ 64</u>

See Accompanying Independent Auditors' Report.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Honorable Robert Ruecho
Governor, State of Yap
Federated States of Micronesia:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap as of and for the year ended September 30, 2004, which collectively comprise the State of Yap's basic financial statements and have issued our report thereon dated March 6, 2006. Our report on the General Fund was qualified due to our inability to determine the amount, if any, of a valuation allowance for an investment and we expressed an adverse opinion on the aggregate discretely presented component units, due to our inability to determine the propriety of fixed assets of the Yap Fishing Authority and the Diving Seagull, Inc. and the lack of audited financial statements of Yap Fresh Tuna, Inc. Except as discussed in the preceding sentence, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

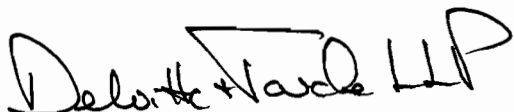
In planning and performing our audit, we considered the State of Yap's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the State of Yap's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs (pages 80 through 95) as items 2004-6 through 2004-12.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider item 2000-8 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Yap's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-1 through 2004-5.

This report is intended solely for the information and use of the management of the State of Yap, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than those specified parties.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, stylized font.

March 6, 2006

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Honorable Robert Ruecho
Governor, State of Yap
Federated States of Micronesia:

Compliance

We have audited the compliance of the State of Yap with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2004. The State of Yap's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs (pages 80 through 95). Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of Yap's management. Our responsibility is to express an opinion on the State of Yap's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of Yap's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of Yap's compliance with those requirements.

As described in items 2004-1 through 2004-5 in the accompanying Schedule of Findings and Questioned Costs, the State of Yap did not comply with requirements regarding equipment and real property management, allowable costs/cost principles, and procurement and suspension and debarment that are applicable to its major federal programs. Compliance with such requirements is necessary, in our opinion, for the State of Yap to comply with the requirements applicable to its major federal programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the State of Yap complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2004.

Internal Control Over Compliance

The management of the State of Yap is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of Yap's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

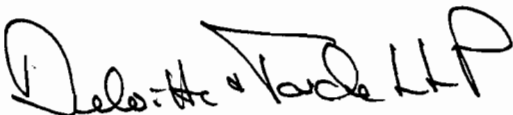
We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the State of Yap's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 2004-1 through 2004-5.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider none to be a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Yap as of and for the year ended September 30, 2004, and have issued our report thereon dated March 6, 2006, which report on the General Fund was qualified due to our inability to determine the amount, if any, of a valuation allowance for an investment; and, we expressed an adverse opinion on the aggregate discretely presented component units, due to our inability to determine the propriety of fixed assets of the Yap Fishing Authority and the Diving Seagull, Inc., and the lack of audited financial statements of Yap Fresh Tuna, Inc. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the State of Yap's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (pages 70 through 77) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the State of Yap. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the management of the State of Yap, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.



March 6, 2006

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards
Federal Grants Fund
Year Ended September 30, 2004

<u>Grantor Program Title</u>	<u>CFDA No.</u>	2004 Fiscal Year Expenditures
<u>U.S. Department of Education:</u>		
2001 - PVIEP	84.048B	\$ 1,272
2004 - PVIEP	84.048B	115,189
Total CFDA # 84.048B		116,461
FY03 Special Education	84.027B	16,154
FY04 Special Education	84.027B	552,299
Total CFDA # 84.027B		568,453
FASEG 2001	84.256A	892
Freely Associated States Ed Grant 7/03-6/04	84.256A	369,629
Total CFDA # 84.256A		370,521
Bilingual Education	84.288S	134,964
Total CFDA # 84.288S		134,964
FY-04 Teacher Quality Enhancement	84.336	257
Total CFDA # 84.336		257
Total U.S. Department of Education		1,190,656
<u>U.S. Department of Labor:</u>		
2001 WIA Title I - Administration	17.250	50
2002 WIA Title I - Administration	17.250	1,833
2003 WIA Title I - Administration	17.250	9,695
Total CFDA # 17.250		11,578
2001 WIA Title I - Adult	17.258	996
2002 WIA Title I - Adult	17.258	26,035
2003 WIA Title I - Adult	17.258	11,208
Total CFDA # 17.258		38,239
2003 WIA Title I - Youth	17.259	26,781
2001 WIA Title I - Youth	17.259	4,056
2002 WIA Title I - Youth	17.259	6,882
Total CFDA # 17.259		37,719
2001 WIA Title I - Dislocated Worker	17.260	6,193
2002 WIA Title I - Dislocated Worker	17.260	31,125
2003 WIA Title I - Dislocated Worker	17.260	1,888
Total CFDA # 17.260		39,206
Total U.S. Department of Labor		126,742

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Federal Grants Fund
Year Ended September 30, 2004

<u>U.S. Department of Agriculture:</u>		
Emergency Food Donation	10.569	113,837
Total CFDA # 10.569		<u>113,837</u>
03 FRM/ RGNR	10.664	300
FY03 Forestry Urban Community	10.664	5,015
03 Yap Forest Health Project	10.664	827
03 Yap Forest Management	10.664	95
03 Yap Conservation Education	10.664	4,386
04 Forestry Urban Community	10.664	36,122
04 Yap Forest Health Project	10.664	1,646
04 FRM / RGNR	10.664	4,880
04 Suppression Fund	10.664	4,570
04 Yap Conservation Education	10.664	787
04 FRM	10.664	6,681
Total CFDA # 10.664		<u>65,309</u>
Total U.S. Department of Agriculture		<u>179,146</u>
 <u>U.S. Department of the Interior:</u>		
FY00 HPO - Historic Operation	15.904	1,805
FY-01-02 HPO Administration	15.904	3,618
FY-01-02 HPO Special	15.904	842
FY-01-02 HPO Archaeology	15.904	10,540
FY02 HPO Administration	15.904	12,544
FY02 HPO Special	15.904	24,435
FY02 HPO Archaeology	15.904	28,141
Total CFDA # 15.904		<u>81,925</u>
Yap Hospital Renov./Maint.	15.875	349,400
Total CFDA # 15.875		<u>349,400</u>
Total U.S. Department of the Interior		<u>431,325</u>
 <u>U.S. Department of Health and Human Services:</u>		
FY /02/03/04/05 Family Planning	93.217	28,834
Total CFDA # 93.217		<u>28,834</u>
2003 Immunization Program	93.268	14,218
2004 Immunization Program	93.268	15,608
Total CFDA # 93.268		<u>29,826</u>
2003 Tobacco Program	93.283	4,652
FY-03 Tobacco Free Coalition	93.283	1,415
Total CFDA # 93.283		<u>6,067</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Federal Grants Fund
Year Ended September 30, 2004

U.S. Department of Health and Human Services, Continued:

FY03 SAPT	93.959	6,042
Yap Seed		
2003 - Yap Seed Program	93.959	2,418
2004 - Yap Seed YHS Transition	93.959	13,237
FY04 SAPT	93.959	31,149
Total CFDA # 93.959		<u>52,846</u>
FY 03 Diabetes Program	93.988	85
FY04 Diabetes Program	93.988	4,364
FY05 Diabetes Program	93.988	3,590
Total CFDA # 93.988		<u>8,039</u>
FY01 MCH	93.944	795
FY02 MCH	93.944	208
FY03 MCH	93.944	53,661
Total CFDA # 93.944		<u>54,664</u>
FY03 Tuberculosis & AIDS Program	93.116	4,666
FY04 Tuberculosis & AIDS Program	93.116	12,475
Total CFDA # 93.116		<u>17,141</u>
2003 AIDS Prevention	93.940	6,043
2004 AIDS Prevention	93.940	4,902
Total CFDA # 93.940		<u>10,945</u>
2004 Yap Bioterrorism- Area C Lab	93.003	1,554
Bioterrorism Hospital BM2-2	93.003	13,000
Total CFDA # 93.003		<u>14,554</u>
Total U.S. Department of Health and Human Services		<u>222,916</u>
Total Federal Grants Fund		<u>\$ 2,150,785</u>
Schedule of Expenditures of Federal Awards balance		<u>\$ 2,150,785</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Other U.S. Grants Fund
Year Ended September 30, 2004

<u>Grantor Program</u>	<u>CFDA No.</u>	<u>2004 Fiscal Year Expenditures</u>
U.S. Department of Homeland Security: Public Assistance Grants	97.036	<u>\$ 1,240,996</u>

We noted that the Federal Emergency Management Agency (FEMA) was paid \$408,692 in the subsequent period for matching of FY'04 assistance for the Individuals & Households Program (IHP). 100% of these funds totaling \$1,634,768 were disbursed directly to households from FEMA as of June 2004 (these didn't pass through Yap State). However, it is Yap State's responsibility to reimburse FEMA for the 25% local share at \$408,692. The local share was later appropriated through Law 6-41 at October 11, 2004 for which payment was made out of the General Fund at November 8, 2004.

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Program Funds (CFDA 15.875)
Year Ended September 30, 2004

<u>Grantor Program Title</u>	<u>Compact Section</u>	<u>2004 Fiscal Year Expenditures</u>
<u>Special Block Grant Programs</u>		
Clinical Care Division	221 (B)	\$ 260
Yap Proper Elementary School	221 (B)	1,287
Yap Proper High School	221 (B)	9,989
O.I. Elementary Schools	221 (B)	1,162
O.I. Middle Schools	221 (B)	1,457
Ancillary Services Division	221 (B)	<u>28,906</u>
Total Compact of Free Association Compact Section 221 (B) Program Fund		<u>43,061</u>
<u>Post Secondary Education</u>		
Scholarships and grants	216 (A) (3)	<u>(3,750)</u>
Total Compact of Free Association Compact Section 216 (A)(3) Program Fund		<u>(3,750)</u>
<u>Energy Programs</u>		
State Utilities Program	214 (B)	<u>1,903</u>
Total Compact of Free Association Compact Section 214 (B) Program Fund		<u>1,903</u>
Total Compact of Free Association Compact Program Fund		<u>\$ 41,214</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Capital Fund
Section 211 (A) Capital Account (CFDA No. 15.875)
Year Ended September 30, 2004

<u>Grantor</u> <u>Program Title</u>	<u>2004</u> <u>Fiscal Year</u> <u>Expenditures</u>
<u>Office of Insular Affairs</u>	
Yap Sports Complex	\$ 29,896
Southern Yap Road	563,843
Land Purchase	<u>74,365</u>
Total Compact of Free Association Capital Projects Fund 211 (A)	<u><u>\$ 668,104</u></u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Program Funds
Year Ended September 30, 2004

<u>Grantor</u> <u>Program Title</u>	2004 <u>Fiscal Year</u> <u>Expenditures</u>
<u>Compact Section 211 (a) (1) Education Sector Grants:</u>	
Manpower Development - skills training	\$ 87,046
DOE Administration	129,031
Curriculum	68,127
DOE Procurement	24,773
Outer Island Elementary Education	723,281
Yap Proper Elementary Education	597,391
Woleai High School	130,035
Ulithi High School	215,952
Yap High School	568,273
Cultural Programs	256,620
Scholarship	52,000
Aid to Private Schools	31,395
Total Compact Section 211 (a)(1) Education Sector	2,883,924
<u>Compact Section 211 (a) (2) Health Sector Grants:</u>	
Extension Services	9,998
Hospital Medical & Clinical	571,117
DHES Ancillary Services	372,451
Medical Supply and Equipment	321,301
Public Health	326,477
Primary Health	133,339
Sanitation	15,455
Dental Services	71,736
Total Compact Section 211 (a)(2) Health Sector	1,821,874
<u>Compact Section 211 (a) (3) Private Sector Development Grants:</u>	
Agriculture Extension	46,564
Forestry Development	1,348
Skills Training	423
R&D Administration	7,453
Management and Survey	61,120
Land Registration	18,135
Investment Promotion	30,778
Small Business Development Center	160,897
Yap Visitor's Bureau	102,954
Total Compact Section 211 (a)(3) Private Sector Development	429,672

See accompanying notes to Schedule of Expenditures of Federal Awards.

STATE OF YAP
FEDERATED STATES OF MICRONESIA

Schedule of Expenditures of Federal Awards, Continued
Compact of Free Association Compact Program Funds
Year Ended September 30, 2004

<u>Compact Section 211 (a) (4) Private Sector Capacity Building Grants:</u>	
Judiciary	168,402
State Auditor	93,684
Office of Administrative Services	311,071
Office of Planning and Budget	148,172
Resources & Development	65,503
Attorney General	<u>429,648</u>
Total Compact Section 211 (a)(4) Public Sector Capacity Building	<u>1,216,480</u>
 <u>Compact Section 211 (a) (5) Environment Sector Grants:</u>	
R&D Administration	5,411
Agriculture Division	15,787
Marine Resources Division	10,861
Manpower Development Division	9,328
Public Works Road Maintenance	118,777
Environmental Protection Agency	64,434
Historical Preservation Office	77,007
Yap Cap - Rural Sanitation	40,977
Yap Cap - Environmental	<u>26,960</u>
Total Compact Section 211 (a)(5) Environment Sector	<u>369,542</u>
Total Compact of Free Association Section 211 Grants	<u><u>\$ 6,721,492</u></u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2004

(1) Scope

The Yap State Government is a governmental entity governed by its own Constitution. All significant operations of the State of Yap are included in the scope of the OMB Circular A-133 audit (the "Single Audit"). The U.S. Department of the Interior has been designated as the State's cognizant agency for the Single Audit.

A. Programs Subject to Single Audit

- U.S. Department of Agriculture
- U.S. Department of Education
- U.S. Department of Health and Human Services
- U.S. Department of Homeland Security
- U.S. Department of the Interior
- U.S. Department of Labor

(2) Summary of Significant Accounting Policies

A. Basis of Accounting

For purposes of this report, certain accounting procedures were followed which help illustrate the expenditures of the individual programs. All expenses and capital outlays are reported as expenditures. The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

B. Reporting Entity

The Yap State Government, for purpose of the financial statements, includes all of the funds of the primary government as defined by Governmental Accounting Standards Board (GASB) Statement 14, "The Financial Reporting Entity".

(3) Component Units

In prior years, the Yap Community Action Program (YAPCAP) was classified as a component unit. In 2001, due to the State operating the Headstart Program, YAPCAP is no longer classified as a component unit. The State operated the Program until March 31, 2002 and then transferred responsibility thereafter, to a non-profit corporation.

The Yap State Public Service Corporation (YSPSC) programs are received in a subrecipient capacity. No federal awards were expended in fiscal year 2004 exceeding threshold and therefore compliance testing was not performed.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Programs Selected for
Audit In Accordance With OMB Circular A-133
Year Ended September 30, 2004

<u>Grantor Program Title</u>	<u>CFDA No.</u>	<u>2004 Fiscal Year Expenditures</u>
<u>U.S. Department of the Interior</u>		
Compact of Free Association, Capital Projects Fund, Section 211(A) Capital Account	15.875	\$ 668,104
Compact of Free Association, Sector Grants	15.875	6,721,492
Yap Hospital Renovation/Maintenance	15.875	<u>349,400</u>
Total U.S. Department of the Interior		\$ <u>7,738,996</u>
<u>U.S. Department of Education</u>		
Yap Special Education (SEPIIE Grant) (Grant # 3256 A01-0004-02)	84.027B	\$ 568,453
Freely Associated States Education Grant	84.256A	<u>370,521</u>
Total U.S. Department of Education		\$ <u>938,974</u>
<u>U.S. Department of Homeland Security</u>		
Public Assistance Grants	97.036	\$ <u>1,240,996</u>
Total U.S. Department of Homeland Security		\$ <u>1,240,996</u>
Total U.S. Federal program expenditures selected		\$ <u>9,918,966</u>
Total U.S. Federal program expenditures		\$ <u>10,822,591</u>
% of total U.S. Federal expenditures covered by major programs		<u>91%</u>

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs
Year Ended September 30, 2004

Part I - Summary of Auditors' Results Section

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion on the business-type activities, the U.S. Federal Grants Fund, the Compact Sector Grants Fund, the Compact Trust Fund, and the aggregate remaining fund of the governmental activities, a qualified opinion on the General Fund due to our inability to determine the amount, if any, of a valuation allowance for an investment; and an adverse opinion on the aggregate discretely presented component units due to our inability to determine the proprietary of fixed assets of the Yap Fishing Authority and the Diving Seagull, Inc. and the lack of audited financial statements of Yap Fresh Tuna, Inc.
2. Reportable conditions in internal control over financial reporting were identified, one of which is considered to be a material weakness.
3. Instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, none of which is considered to be a material weakness.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The State's major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Compact of Free Association, Capital Projects Fund, Section 211 (A)	15.875
Compact of Free Association, Sector Grants	15.875
Yap Hospital Renovation/Maintenance Grant	15.875
Freely Associated States Education Grant	84.256A
Special Education (SEPIIE Grant)	84.027B
Public Assistance Grant	97.036

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The State did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2004-6	Fixed Assets	\$ -
2004-7	Payroll	\$ -
2004-8	Unsupported Liquidation of Purchase Advances	\$ -
2004-9	Outstanding Encumbrances	\$ -
2004-10	Travel Advances	\$ -
2004-11	Approval of Payroll Master File Changes	\$ -
2004-12	Bank Reconciliation	\$ -

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Part III - Federal Award Findings and Questioned Cost Section

<u>Reference Number</u>	<u>CFDA Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
2004-1	97.036	Procurement, Suspension and Debarment	\$ -
2004-2	97.036	Allowable Costs/Cost Principles	\$ -
2004-3	84.256A	Procurement, Suspension and Debarment	\$ 20,750
2004-4	84.027	Procurement, Suspension and Debarment	\$ 12,446
2004-5	All	Equipment and Real Property Management	\$ -

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-1
CFDA No.: 97.036
Grantor: U.S. Department of Homeland Security (DHS)
Area: Procurement
Questioned Costs: \$0

Criteria: Federal regulations state that all procurement transactions will be conducted in a manner providing for full and open competition. Grantees and subgrantees will use their own procurement procedures, which reflect applicable State and local laws and regulations providing that the procurements conform to applicable federal law.

Condition: Of \$435,736 in DHS non-payroll expenditures tested, we noted two disbursements for \$48,800 (APV#19434) and \$4,307 (APV#18284) pertaining to Disaster 1511 PW 309 for which bidding documents, quotes, or certification of calls made to evidence full and open competition were not provided.

Cause: Due to the nature of the emergency, there was a waiver of procurement procedures by the Governor, and any documentation of verbally acquired quotes was not maintained.

Effect: No questioned costs result from this matter after we verified the information provided in the auditee response.

Recommendation: Management should ensure that documentation is maintained and procurement regulations complied with at the point in time that procurements are initiated.

Auditee Response and Corrective Action Plan: The finding pertains to the repair of the roof at the Yap Memorial Hospital. At the time of Typhoon Sudal, Pacific Modair Corporation was already repairing the roof under another contract with YMH that had been competitively awarded. Public Works felt it in the public interest that Pacific Modair also repair the roof damages from Typhoon Sudal and requested a waiver from the bidding requirements in a May 24, 2004 letter to the Governor. The Governor approved the waiver on June 15, 2004 and a change order was added to the original contract to accommodate the temporary repairs necessitated by Typhoon Sudal.

Documentation is on file with the Yap Department of Public Works.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-2
CFDA No.: 97.036
Grantor: U.S. Department of Homeland Security (DHS)
Area: Allowable Costs/Cost Principles
Questioned Costs: \$0

Criteria: Allowable costs are for the approved project and scope of work indicated on project worksheets.

Condition: Of \$435,736 in DHA non-payroll expenditures tested, we noted a project overrun of \$54,085 for Disaster 1511 PW #34, and of \$24,350 in payroll expenditures tested, we noted a project overrun of \$4,466 for Disaster 1511 PW #444. As of our fieldwork date (over a year after overruns had occurred), approval from FEMA had not been obtained. Such was corrected through an entity adjustment that transferred overruns back to the General Fund.

Cause: The cause is the untimely reconciliation of records between the Public Assistance Office and the Office of Administrative Services as well as a delay in obtaining necessary approvals from the grantor.

Effect: The impact may be unbudgeted expenditures in the General Fund and the loss of grantor revenue.

Recommendation: Management should ensure that overruns are monitored and addressed on a timely basis.

Auditee Response and Corrective Action Plan: As noted in the finding condition, Yap State Finance adjusted the budget overruns on the two projects with corrective journal vouchers on September 30, 2004. The delay was the result of having first charged FEMA related expenditures to the general fund and waiting until after FY-05 to transfer the related charges to the FEMA grant fund. As a result, these two projects experienced overruns that had to be transferred back to the general fund. Because typhoon Sudal is still an open, FEMA may subsequently approve these additional expenditures but that determination could not be made at the date of the audit.

The Assistant Director of Public works is the responsible official for reviewing the FEMA accounts and all project accounts for Lupit and Sudal are now within the approved budgets as of September 30, 2005.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-3
CFDA No.: 84.256A
Grantor: U.S. Department of Education
Area: Procurement, Suspension and Debarment
Questioned Costs: \$20,750

Criteria: Expenditures charged to federal programs should be properly justified.

Condition:

1. The following expenditures are questioned as no indication of competitive procurement was documented.

EMI Enterprises	APV #15024	\$ 3,500.00
Velauthapilla Sellathurai	APV #13894	\$ 6,000.00
Dr. Cesar & Araceli Hidalgo	APV #15955	\$11,250.00

2. Payment of telephone charges for the Department of Education for various months were not properly allocated. The total amount due was charged to the program. Instances of details of phone charges were not readily on file and only a delinquent billing summary supported the payment per the accounts payable voucher.

FSM Telecom Corp.	APV #17058	\$19,262.22
FSM Telecom Corp.	APV #18760	\$ 6,528.73
FSM Telecom Corp.	APV #1656	\$ 2,926.44
FSM Telecom Corp.	APV #14047	\$17,428.55
FSM Telecom Corp.	APV #14941	\$ 4,300.00
FSM Telecom Corp.	APV #14047	\$ 5,441.69

Cause: The cause of this condition appears to be inadequate competitive procurement documentation and inadequate support of telecommunications bills charged to the program.

Effect: The effect of this condition is questioned costs of \$20,750 for the items specified in condition 1. No questioned costs are raised for the matters in section 2 as the Department was subsequently able to provide detail to help substantiate the propriety of the communication charges.

Recommendation: Competitive procurement activities should be documented and charges to the program should bear adequate documentation to substantiate their purpose and the manner in which such meet budgetary requirements.

Auditee Response and Corrective Action Plan:

1. All the expenditures cited were legitimate FASEG program expenditures, which we do not feel require competitive procurement:
 - The payment to EMI Enterprises was for an apartment rental for a program staff employee.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-3, Continued
CFDA No.: 84.256A
Grantor: U.S. Department of Education
Area: Procurement, Suspension and Debarment
Questioned Costs: \$20,750

Auditee Response and Corrective Action Plan, Continued:

- The payment to V. Sellathurai was for a contract to work on the Science handbook; the contractor having been a former science teacher at YHS. The rationale for the procurement was the contractor's unique familiarity with the science program in Yap secondary schools and the prohibitive budget impact if the DOE had to contract with an off-island contractor. After completion of this contract, Mr. Sellathurai was hired to work at the high school, but during the performance of the contract he was not otherwise employed.
 - The payment to the Hidalgos were for two education consultants to work on the New Baseline Curriculum (NBC). No formal bid process was used to recruit these consultants because it was felt essential to contract with consultants who were familiar with Yap State's previous efforts in writing the curriculum in the five languages used in Yap elementary schools. Two other individuals who had worked on the curriculum were approached, but both were unavailable to work on the NBC. The Hidalgos, who had also been involved in prior years in developing DOE's vernacular curriculum were then contracted with because of their unique familiarity with the Yap Curriculum. We acknowledge the oversight in not obtaining prior grantor agency approval for the special circumstances surrounding this contract and not documenting the procurement process. It is now standard procedure to competitively bid consultant contracts or otherwise obtain prior approval and document special procurement circumstances
2. The telephone bills represented charges for Oct-Nov, 2003. The invoices were available for the November charges, but DOF had paid the October charges based on the beginning balance brought forward. DOF has since obtained from FSM Telecom the detail for the October charges. We do not agree that the telecomm charges were improperly allocated. The telephone charges are for the internet connections and computer laboratory at the DOE central office and other schools on Yap proper and in the neighboring islands that use the internet in their courses. The FASEG program has always covered these charges because they support the lab and internet access essential to meet DOE's instructional and in-service training initiatives encompassed by the FASEG grants. Moreover, non-internet telecom charges are allocated to the specific departments under alternative funding sources. It is now the policy of DOF to not pay on any invoice balance-forward amounts without the detail support for the balances brought forward. Moreover, DOE will not approve for payment any invoices without supporting documentation; this policy became effective with the appointment of the new Director, DOE in FY-04.

Auditor Response: While the Department may have knowledge that such are legitimate program expenses, the documentation submitted in support of payments does not indicate either the procurement rationale (as in condition 1.) or the manner in which the program benefited or met program budgetary requirements (as in condition 2.) Additionally, the reference to the Hidalgo contracts does not indicate that prior contracts were also questioned in prior audits due to the lack of compliance with federal procurement requirements.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-4
CFDA No.: 84.027 – Special Education
Grantor: U.S. Department of Education
Area: Procurement, Suspension and Debarment
Questioned Costs: \$12,446

Criteria: The State should ensure that competitive procurement determinations are documented in file.

Condition:

There were no competitive procurement procedures documented in file for the following expenditures.

APV #20792	\$3,545.00
APV #15285	2,577.44
APV #19267	4,861.90
APV #16018	1,461.50

Cause: The cause of this condition is inadequate documentation in support of competitive procurement decisions.

Effect: The effect of this condition is questioned costs of \$12,446.

Recommendation: The State should ensure that its competitive procurement determinations conform to the federal requirements.

Auditee Response and Corrective Action Plan:

- 1) APV 20792 - Payment by DOE (Special Ed) for used car. The former coordinator went to four vendors (YCA, 7D, PBC, and EMI) and only 7D had a used sedan available.
- 2) APV 15285 – Payment by DOE (Special Ed) to YCA for furniture and office supplies. Quotations from PBC, EMI and YCA with YCA the cheapest.
- 3) APV19267- Payment by DOE (Special Ed) to YCA for office furniture This procurement was done immediately after the typhoon; informal quotations were solicited from PBC, EMI, and YCA, but only YCA had stock available that had not been damaged by the typhoon.
- 4) APV 16018 – Payment by DOE (Special Ed) for flywheel assembly for the Spec Ed program vehicle that was undergoing repairs at the shop. This was an amendment to P13268 for which quotations were received from PTS, RAC, and PBC Auto shops, with PTS selected. Additional part was needed after repairs were started.
- 5) The purchase order for APV 15285 was approved by Spec. Ed Coordinator, Maria Waathan. The lack of approval on the APV was an oversight.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-4, Continued
CFDA No.: 84.027 – Special Education
Grantor: U.S. Department of Education
Area: Procurement, Suspension and Debarment
Questioned Costs: \$12,446

Auditee Response and Corrective Action Plan, Continued:

It is now the policy of the Yap State Government to require competitive procurement for all purchases, regardless of funding source. YSL 6-53, effective October 5, 2005 incorporates federal small procurement rules into Yap Law; three vendor quotes are required for all personal property costing less than \$5,000.

Auditor Response: The response appears to indicate that the State does not document its informal competitive procurement activities. We recommend that the State ensure that its corrective action plan is strictly followed.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.:	2004-05
CFDA No.:	15.875 – Compact of Free Association, Sector Grants
Grantor Agency:	U.S. Department of the Interior
CFDA No.:	84.256A – Freely Associated States Education Grant
Grantor Agency:	U.S. Department of Education
CFDA No.:	84.027B – Special Education Grant
Grantor Agency:	U.S. Department of Education
CFDA No.:	97.036 – Public Assistance Grant
Grantor Agency:	U.S. Department of Homeland Security
Program/Area:	Equipment and Real Property Management
Questioned Costs:	\$0

Criteria: Fixed assets should be properly identified.

Condition: Fixed assets greater than \$5,000 per unit were unable to be identified.

Cause: There is no current system in place that appears to assign identification tags to individual fixed assets. We understand that the State will be subsequently defining fixed assets at a higher threshold (\$5,000) and this action should assist in resolving this finding.

Effect: The inability to properly identify fixed assets may increase the risk of not identifying potential problems or abuse in a timely manner.

Prior Year Status: This matter was reported in the 2003 Single Audit Report.

Recommendation: The Federated States of Micronesia as a whole has moved to adopting the federal equipment standard and this process should assist the State in its fixed asset inventory management.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The inventory and tagging of fixed assets is being performed by the Division of Procurement & Property Management and will be completed by December 31, 2005. A fixed asset register is being concurrently prepared with this inventory. Additionally, the Director, Office of Administrative Services will submit promulgate proposed changes to amend the Yap State Procurement Code to raise the capitalization threshold of capital assets to \$5,000, in line with the FSM and federal equipment standards. These amendments will be proposed no later than November 30, 2005.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-6
Area: Fixed Assets

Criteria: The State should retain documentation supporting the capitalization of assets and should ensure that the accounts payable vouchers, invoices and other authoritative documents exist in support of the payments.

Condition:

- 1) The accounts payable voucher packages in support of the following purchases were not made available for our examination.

Diagnostic Ultrasound Equipment	\$31,248.57
Radios and Accessories	\$35,419.06
Ford Crown Victoria	\$18,970.98

- 2) A deposit of \$30,000 to purchase a large capacity garbage truck has been outstanding and has not yet been received. Therefore, this item should be reflected as an advance receivable and not as a fixed asset acquisition.

Cause: The cause of the condition appears to be that certain accounts payable vouchers have yet to be located and that an advance payment may have been improperly capitalized.

Effect: The effect of this condition is that substantiation of the above assets has yet to be located and that errors can exist in the fixed asset register if assets are incorrectly capitalized.

Recommendation: We recommend that the missing accounts payable voucher packages be located and that assets not be capitalized until received and placed in service.

Auditee Response and Corrective Action Plan:

1. Supporting documents are now available to substantiate purchases.
2. There has been consistent follow-up by the Department of Public Works concerning the deposit to YCA of \$30,000 for the garbage truck. YCA won the bid on the garbage truck, but placing the order was contingent on PW&T receiving a grant from Rural Development; a process that has taken almost two years to receive an additional \$75,000 to supplement the original deposit. The order will be placed by March 2006.

The Chief accountant of Yap State is responsible for maintaining the fixed asset register and Yap is now current on updating this document.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-7
Area: Payroll

Criteria: Payroll withholdings and calculations should be properly supported.

Condition:

1. Overpayment of Overtime (OT)

For employee no. 704534, actual hours worked reported per the time summary report were inaccurate. The employee should have received OT pay of \$390.39 and \$330.33 for the PPE 6/12/04 and PPE 6/26/04, respectively. The error resulted in an overpayment of OT to the employee in the amount of \$120.12 and \$87.94, respectively.

2. Allotment Authorizations

For 16 of 30 payroll samples, amounts per withholding authorizations do not correspond with actual payroll deductions and amounts recorded in the payroll register. In some cases, authorization allowing vendor deductions could not be found and/or no authorization could be found discontinuing the specific allotment. Also, different withholding forms are used when initiating or discontinuing an allotment.

Cause: The cause of the first condition appears to be an error and the second condition appears to be the constantly changing requests of employees to alter allotment forms.

Effect: The effect of condition 1 is an overpayment that should be collected from the employee. There is no defined financial statement impact as a result of the second condition.

Recommendation: We recommend that recovery from the employee cited in condition 1 occur and that the State continue its attempts to ensure adequate documentation of allotments.

Auditee Response and Corrective Action Plan:

1. The overpayments of overtime resulted from duplicate authorization for overtime hours for typhoon Sudal work; once by the requesting department and a second time by OPB.
2. Proper filing of allotment advices has been a recurring problem within the payroll department but the primary control remains with the employees who are very aware of their withholdings, all of which are indicated on the employee copy of the payroll check stub.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-8
Area: Unsupported Liquidation of Purchase Advances

Criteria: Purchase advances and encumbrances should be properly liquidated in a timely manner based upon confirmation that goods have been received or services provided.

Condition: Of \$2,155,006 in General Fund expenditures tested, we noted the following:

- The State wrote off \$72,222 in purchase order advances (J412096) from one company without receipt of items purchased due to the bankruptcy of the vendor. The initial advance of \$51,000 was made in fiscal year 2003 (ck#3121) and without confirmation that items had been received, another \$15,000 was issued to the same vendor for same purchase order in March 2004.
- The State liquidated \$107,831 of fiscal year 2002 related purchase advances (J412096) without confirmation that goods were received or services rendered.
- The State liquidated \$132,236 (J412096) of purchase advances because advances were over six months old and were less than \$10k, regardless of whether or not the items were received or services performed.
- Although it was indicated that receiving reports and invoices were received, receiving reports and invoices were either not provided or there was no clear indication of items and related amounts received to support five liquidated advances (P9339, P19261, P15362, P19268, P19361).

Cause: Goods are received by requesting departments. Receiving reports and/or invoices are often delayed or are never forwarded to the Office of Administrative Services.

Effect: This condition results in improper and untimely liquidation of purchase advances, and write-offs could result in possible loss of federal revenue if the advance was originally related to a federal program.

Recommendation: We recommend that departments submit receiving reports and invoices in a timely manner.

Auditee Response and Corrective Action Plan:

We agree with the finding and recommendation. The problem with timely clearance of advances to vendors has become more important as more vendors require advance payment for items shipped to the Pacific. This is almost always the case for big-ticket items such as vehicles, computers, textbooks, and medical supplies. Moreover, timely clearing of advances related to Compact sector grants is now essential in order to obtain the appropriate reimbursements on a timely basis. As noted above, the process of clearing the advance account at September 30, 2004 entailed making assumptions about old open items. These were very conservative assumptions. Because the research was performed in November, 2005, all the items cleared under these assumptions were over 18 months old and consequently, presumed eligible to be expended.

Effective in October 2006, the Department of Finance has implemented procedures to research open items on a monthly basis and appropriately expense if received. The Chief of Finance is the responsible official to oversee this task and is now current in FY-06.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-9
Area: Outstanding Encumbrances

Criteria: Encumbrances should not remain outstanding for more than 18 months unless related to construction projects.

Condition: At September 30, 2004, there was \$5,982,901 in open encumbrances of which \$1,088,286 was still outstanding as of December 10, 2005. Of the \$1,088,286, \$414,742 of non-construction related amounts originated in fiscal year 2002.

Cause: Encumbrances are not being reconciled or monitored to ensure their continued viability.

Effect: Liquidation and write-off of valid encumbrances may not occur in the proper period.

Recommendation: Encumbrances should be reconciled and liquidated in a timely manner.

Auditee Response and Corrective Action Plan: We agree with the finding and reconciliation. In January 2006, Yap State Finance researched all open encumbrances and cancelled those that were invalid. Approximately \$600,000 was cancelled as of 9-30-05; which will have a positive effect on unreserved fund balance for that year's financial statements. Only valid open encumbrances will be converted into the new software upgrade in February 2006. Yap Chief of Finance is responsible for reconciling encumbrances and the task was completed in January 2006.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-10
Area: Travel Advances

Criteria: Travel advances should be resolved in a timely manner.

Condition: Follow up or mandatory withholding of travel advances is not occurring and reconciliations of the accounts are not occurring.

Cause: The State does not appear to be ensuring compliance with the criteria.

Effect: Cash flows could be adversely impacted and travel advances may have to be written off.

Recommendation: The State should consider automatically collecting the advances through payroll deductions and should reconcile the travel advance subledger to the general ledger on a monthly basis.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. Currently, travel advances are only reconciled at year-end as part of the annual audit tasks and payroll deductions are not being made for those employees who have not filed travel expense claims. The exception in FY-04 was the cancellation of all travel advances charged to sector grants that were still open as of December 31, 2005. The travel accountant in the Finance department will be the responsible official for performing monthly reconciliations and making deductions of outstanding advances when appropriate. Target date is December 31, 2005.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-11
Area: Approval of Payroll Master File Changes

Criteria: All payroll master file changes should be properly edited and approved.

Condition: No edits or approvals of changes to master file information are documented. Such appear unilaterally performed.

Cause: No documented review process is required.

Effect: Unauthorized changes to the master files could occur and go undetected.

Recommendation: An edit of changes should be printed and proven by a higher level and that review should be evidenced in writing.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. We will explore with our software vendor the possibility of having a report print of masterfile changes that could then be used to obtain higher approvals. The Director, OAS, will be the responsible official with planned implementation in FY-06.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2004

Finding No.: 2004-12
Area: Bank Reconciliation

Criteria: Cash in bank per the general ledger and per bank should be reconciled on a monthly basis.

Condition: During tests of bank reconciliations, we noted the following:

- A total of \$26,981 was not reconciled in the bank reconciliation of the Treasury Fund 99 cash account 1106.
- One check (#3879) for \$1,460.79 cleared at January 8, 2003, but was included in the outstanding check list for the Treasury Fund 99 cash account 1106. As this is the payroll checking account, there may be more checks included in the outstanding checklist that have cleared, especially those that are stale-dated.
- Treasury Fund 99 cash account 1105 has a long-standing balance of (\$72,517), which represents checks that have cleared, which are not reconciled to the general ledger.

Cause: Bank reconciliations are not being performed in a timely manner and are not reconciled to the general ledger.

Effect: Misstatements in the financial statements can result from this condition.

Recommendation: Management should require monthly bank reconciliations and ensure the validity of reconciling items.

Auditee Response and Corrective Action Plan: We agree with the finding and recommendation. The general checking account is now being reconciled on a monthly basis and the Chief Accountant was current on this process throughout FY-05. Payroll bank reconciliations are still not on schedule but we expect to be current on this process in June '06. The implementation of the Fundware automated bank reconciliation module will considerably assist these efforts. Of the above reconciling items we note the following at 9-30-05:

- The \$26,981 unreconciled item in the payroll bank account is several years old. Consequently, the book balance will be adjusted to reflect the bank balance as of 9-30-05.
- Effective September 30, 2005, we will write-off to cash, and reconcile in the Fundware system, all outstanding checks in both the payroll and general bank accounts with a date prior to 10-01-04.
- The long-standing balance of (\$72,517) in account 1105 will be written off as of 9-30-05.

The Chief Accountant of Yap State Finance is responsible for becoming current on all bank reconciliations and making the noted adjusting entries.

**STATE OF YAP
FEDERATED STATES OF MICRONESIA**

Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2004

QUESTIONED COSTS

For the year ended September 30, 2004, the following questioned costs remain unresolved.

	Questioned Costs Set Forth in Prior Audit Report <u>2003</u>	<u>Questioned Costs Resolved</u>	<u>Questioned Costs at September 30, 2004</u>
Unresolved Questioned Costs FY 99	\$ 68,619	\$ -	\$ 68,619
Unresolved Questioned Costs FY 00	30,010	-	30,010
Unresolved Questioned Costs FY 01	111,049	52,770 ⁽¹⁾	58,279
Unresolved Questioned Costs FY 02	89,017	2,000 ⁽²⁾	87,017
Unresolved Questioned Costs FY 03	101,558	-	101,558
Unresolved Questioned Costs FY 04	<u>-</u>	<u>-</u>	<u>33,196</u>
	\$ <u>400,253</u>	\$ <u>54,770</u>	\$ <u>378,679</u>

(1) These costs were resolved by the U.S. Department of Education in a letter dated May 23, 2005.

(2) This is correction of an addition error to bring the sum of the questioned costs equal to the outstanding findings.

The prior year status of findings is contained in the accompanying Schedule of Findings and Questioned Costs.